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**INTERNATIONAL AIR TRANSPORT ASSOCIATION**

**COMMENTS ON  
DG-COMPETITION CONSULTATION PAPER  
CONCERNING COMMISSION REGULATION 1617/93**

**NON-CONFIDENTIAL VERSION  
6 September 2004**

## INTRODUCTION

The International Air Transportation Association (“IATA”) submits these comments in response to the Consultation Paper concerning “revision and possible prorogation of Commission Regulation 1617/93” issued by DG Competition on 30 June 2004 (the “Consultation Paper”).

The Consultation Paper sets out preliminary DG Competition views regarding the scope for a revised block exemption regulation defining the application of Article 81 EC Treaty to cooperation between airlines in the context of the IATA multilateral interline system. The Consultation Paper proposes that tariff consultation among airlines for routes between points in the EU, currently permitted under Regulation 1617/93, should be prohibited. The Consultation proposes that consultation between airlines on cargo rates for carriage from the EU to points outside the EU should likewise be prohibited.

IATA recognizes the need for a revised regulation in light of changes in the Commission’s jurisdiction over air transport. IATA strongly disputes, however, both the conclusions set out in the Consultation Paper and the underlying legal and economic analysis. IATA submits that the revised regulation should cover passenger tariff consultations in respect of both routes within the EU and routes between the EU and third countries. IATA further submits that cargo rate consultations for routes between the EU and third countries should be allowed to continue as well.<sup>1</sup>

In this paper, IATA will show that an Article 81(3) regulation<sup>2</sup> covering airline tariff consultations remains fully justified:

- The proposition that IATA fare consultations restrict competition within the meaning of Article 81(1) EC Treaty is not supported by empirical evidence or economic theory.
- Interlining based on IATA tariff consultations creates significant benefits that can only be fully realized within the existing Conference system.
- There are strong policy reasons for keeping in place an Article 81(3) Regulation covering these practices.

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<sup>1</sup> The Consultation Paper also considers the extension of the existing block exemption covering consultations between airlines on scheduling at airports. As the Commission recognizes the clear continuing value of these consultations and their lack of any significant anti-competitive effects, IATA does not propose to address these issues in this paper.

<sup>2</sup> The Consultation Paper refers to the relevant provisions of Regulation 1617/93 as a “block exemption”. This reflects the practice of the Commission and the Community courts under Regulation 17/62, but is not appropriate under the new EU competition law regime. Under Regulation 17/62, Article 81(1) was regarded as the normative rule and Article 81(3) as an exception to that rule, applicable only where the Commission took affirmative action. Thus Commission application of Article 81(3) involved the administrative grant of a derogation from otherwise applicable law, making the term “exemption” appropriate. Under Regulation 1/2003, however, both Article 81(1) and Article 81(3) have equal weight with the implication that Article 81(3) can no longer be regarded as an exception to Article 81(1). In the same way, a Commission regulation “declaring Article 81(1) inapplicable” on the basis of Article 81(3) can no longer properly be described as an “exemption” from Article 81(1): it is rather an administrative act applying Article 81(3) to a category of agreements or practices. These agreements or practices do not, in any case, formally require “exemption”, since they already satisfy the requirements of Article 81(3) which now has direct effect. The purpose of an Article 81(3) regulation under the new EU rules is thus not to “exempt” agreements that otherwise would be unlawful, but to provide legal certainty for practices that are common to an entire sector or industry. The history of the Article 81(3) exemption for IATA Tariff Conferences is described in the Legal Analysis in Annex I, p. 2-5.

As background to this analysis, this paper addresses three preliminary matters: (i) the role of IATA tariff conferences in promoting an efficient interline system; (ii) the significance of changes in the economic and regulatory context for assessment of the IATA multilateral system; and (iii) the appropriate context for assessing the effects and benefits of the IATA multilateral interlining system with specific reference to the complex traffic flow model set out in the Consultation Paper.

## **1 Background**

### **1.1 *Tariff Consultations Form the Basis for an Efficient Interline System***

The purpose of airline tariff consultation under the auspices of IATA is to facilitate “interlining.” Interlining refers to the facility by which a passenger or a shipper can arrange transport that could use the services of more than one airline. For a passenger, an interline booking may involve travel on an itinerary involving stops at intermediate airports and use of a different airline for the onward and/or return journey. A ticket purchased at an interlineable tariff may also allow a passenger to change to another carrier on the same or an alternative routing. For a shipper, an interline shipment involves contracting with an airline for transport of cargo to an airport where the contracting airline either does not serve the airport or may not have a service or capacity available at a time that meets the shipper’s needs.

Tariff consultations facilitate multilateral interlining by creating “industry fares and rates”. These provide the basis for allocation of revenue when a passenger travels or a shipment moves on an itinerary involving multiple sectors and different carriers.<sup>3</sup> Industry fares or rates also provide a basis for a “through fare or rate” that will often be lower than the sum of the fares that individual airlines would charge on the individual sectors comprising an interline itinerary. In addition, industry tariffs provide a basis for acceptance of tickets or air waybills issued by other carriers where a passenger’s travel plans change or a shipment has to be rebooked. Consultations on industry fares or rates in the context of IATA tariff conferences significantly reduce the transaction costs that would result from agreement on fares/rates for specific routes or itineraries between airlines on an *ad hoc* bilateral basis. Last, the IATA tariff conferences are the foundation of all other elements of industry interlining (including integrated reservations, through baggage, and through check-in).<sup>4</sup>

### **1.2 *Assessing the IATA Interline System in the Context of Broader Changes to the Airline Industry and to the Jurisdiction of the European Commission***

The Commission has always recognized the contribution of IATA tariff consultations to an effective industry interline system. Since Article 81(1) EC Treaty became directly applicable to the airline industry in 1987, a regulation has been in effect establishing that IATA tariff

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<sup>3</sup> For ease of reference, this description focuses on passenger interlining. The benefits associated with cargo interlining are similar and are described specifically at page 14 below.

<sup>4</sup> For additional information on the multilateral interline system *see* Annex VII. Annex VII contains the description of the passenger interline system included in IATA’s April 2001 response to the February 2001 DG Competition Consultation Paper.

conferences are allowed under Article 81.<sup>5</sup> Thus, as far as passenger interlining is concerned, the focus of this consultation should be on whether conditions have changed to an extent that the previous Commission findings underlying the present regulations are no longer justified. Careful consideration of the key changes in the airline industry shows, however, that this is not the case.

*The growth of “low-cost” carriers.* A key change, noted in the Consultation Paper, has been the growing importance of so-called “low cost” carriers like Ryanair or easyJet. As the Consultation Paper recognizes, these airlines operate on a different model that does not rely on connecting traffic. They do not participate in IATA tariff consultations and in general do not provide transport on an interline basis.<sup>6</sup> The Consultation Paper fails, however, to recognize the significance of this development for assessment of the multilateral interline system. First, the need to respond to competition from the “low cost” sector, including for business travellers who increasingly find that low-cost carriers offer viable options in many cases,<sup>7</sup> makes it even more unlikely that there is a link between fares set in IATA tariff consultations and fares set by individual IATA airlines. Second, actual or potential competition from “low cost” carriers demonstrates that it is implausible that IATA fare consultations could ever lead to an “elimination of competition” in a significant part of the EU for purposes of Article 81(3). Thus without affecting the benefits of the multilateral interline system, the emergence and growth of low-cost carriers significantly reduces any objections to multilateral interlining based on supposed adverse market effects.

*The growth of code-sharing and airline alliances.* A further key change noted in the Consultation Paper has been the development of code-share agreements between airlines on a bilateral basis, often in the context of broader airline “alliances”.<sup>8</sup> A code-share arrangement

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<sup>5</sup> The Consultation Paper questions whether industry practice regarding interlining is consistent with the definition of interlining set out in Regulation 1617/93. The Commission’s concerns in this regard are misplaced for reasons explained in the Legal Analysis in Annex I, p. 16-18.

<sup>6</sup> Ryanair and easyJet make this point clear on their websites. Under the heading “Flight Connections”, Ryanair writes: “Ryanair is strictly a 'point-to-point' airline whose priority is to offer all of its customers low fare air travel with the best on-time service. However, many factors such as weather, air traffic control delays, strikes, technical disruptions, late inbound aircraft etc. all affect our adherence to published schedules. We therefore do not offer, and cannot facilitate, transfers for passengers or their baggage to other flights whether operated by Ryanair or other carriers. Ryanair accepts no responsibility for making connections and therefore will not be liable for any losses or expenses arising out of any failure to achieve a planned connection.” (See <http://www.ryanair.com/index.html>; see under Customer Service/FAQ – Travel Questions – Flight Connections).

A similar warning can be found on easyJet’s website under the heading “Onward flights”: “If you have booked an onward flight with easyJet, this represents a separate contract. Please note that easyJet does not operate a connecting flight service, and therefore you will need to check-in with your luggage for each sector of your journey in accordance with the check-in requirements below. Consequently we advise that when booking an onward flight with easyJet, you allow at least two hours between the scheduled time of arrival of the incoming flight, and the scheduled time of departure of the onward flight.” (See <http://www.easyjet.com/en/book/regulations.html#onwardflights>).

<sup>7</sup> The Commission recently recognized this point in its decision of 10 December 2003 in Case COMP/D2/38.479 – BA/IB/GB Airways, not yet officially published, paras 27-28.

<sup>8</sup> The Consultation Paper refers to “intra-Alliance” interlining as an alternative to IATA multilateral interlining, implying that promotion of separate alliance-based interline network might be a pro-competitive alternative to multilateral interlining. In reality, however, as the Commission has recognized in its decisions applying both Article 81 and the Merger Regulation to airline coordination and consolidation, it is the bilateral relationships,

allows an airline to attach its flight designator code to a service operated by another airline, and to sell seats on that service as though it operates the service itself. It will be supported by a bilateral arrangement that will define the payments made to the operating carrier. The effect of these arrangements is to increase the number of connecting city pairs where an “on-line” airline-specific fare is available.

IATA recognizes that the proliferation of code share agreements over the past 17 years has reduced the importance of one benefit of multilateral interlining – the setting of direct fares lower than “sum of sector” fares. There are, however, still a substantial number of city pairs that are not served by individual airlines “on-line” either directly or “virtually” by a code share. Of the 437 cities in the EEA with scheduled services, 238 are served by only one or two airlines – and 174 airports have no service by a member of an alliance.<sup>9</sup> Furthermore, there are many more connecting city pairs where the “on-line” connection is substantially less convenient for individual travellers who will still prefer and pay for an interline booking. For many of these passengers, the difference between paying the sum of sectors and a direct IATA fare is still significant.<sup>10</sup> Finally, there are still many routings where the flexibility of changing to services of an airline that does not have special commercial arrangements in place with the first airline is valuable to passengers. Thus while an increase in code sharing may have reduced the benefits of the IATA system compared to seventeen years ago, in no way has code-sharing or the “rise of alliances” made multilateral interlining redundant nor will it make multilateral interlining redundant in the future since code-sharing, alliances and the combination of the two will never be able to duplicate the IATA multilateral interlining system in terms of scope or flexibility.<sup>11</sup>

In addition, the discussion in the Consultation Paper concerning the role of alliances in supplementing or replacing industry standard procedures for baggage handling and through check-in should not be over-estimated. Although alliance partners do work together in these areas, they do so on the basis of the industry platform established within IATA. Furthermore, although eliminating tariff conferences may not end multilateral cooperation on technical interoperability in the short term, a move away from a multilateral system would shift airline incentives further toward enhancing individual alliance brands. Such a trend would lead to

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whether within or outside alliances, that matter from a competition law perspective. The alliances provide platforms on which airlines can build effective bilateral relationships with multiple partners and develop common brands as well as associated brand benefits (*e.g.*, reciprocal frequent flyer programs; joint lounges *etc.*). This distinction is important because the growth of “alliances” over the last ten years does not necessarily reflect a substantial increase in the number of city-pairs covered by code-share arrangements. In many cases, airlines that form “alliance” relationships will already have bilateral code-share agreements with their new alliance partners. In other cases, airlines that join alliances may sever existing code share arrangements outside the alliance.

<sup>9</sup> See Annex II, IATA Annex – Facts About the Economic Geography of Air Transport in the European Economic Area.

<sup>10</sup> See Annex III, IATA Annex – Comparison of IATA and Carrier Fares.

<sup>11</sup> IATA could be considered the one grand, all-inclusive and completely open alliance that generates benefits that no smaller and exclusive alliance could ever achieve. Such an alliance and such benefits should be equally eligible for the legal certainty that competition regulators have provided the smaller, exclusive, code-share based alliances. Many of the bilateral and multilateral arrangements, including those that underpin the alliances, have required antitrust immunity in the US and been the subject of lengthy investigations in the EU. Such arrangements often raise complex competition issues and even in a world of self-assessment will likely require the involvement of competition regulators at some level.

lower standards of interoperability at the industry level, with inevitable consequences for non-aligned carriers and for consumers where an alliance offering is not a realistic option.

*EU expansion.* A change that is important for the Commission's legal assessment and that is surprisingly not addressed in the Consultation Paper is the recent expansion of the EU from 15 to 25 members. The ten new Member States have, in general, a less developed air transport route structure than the EU-15. Airlines based in those Member States are less likely to have developed code-share and alliance relationships. Scheduled frequencies on routes even to major EU airports are often limited. Even where code share arrangements are in place, the location of the new Member States on the Eastern periphery of the EU means that on-line and/or alliance connections will involve less convenient indirect routings. These factors combined mean that IATA multilateral interlining continues to play a substantially greater role in airline traffic to the new Member States, significantly increasing the benefits of the IATA multilateral interline system within the EU compared to three years ago.<sup>12</sup>

*Changes in the Commission's jurisdiction.* It is also important to recognize the implications of the Commission's expanded competition law jurisdiction regarding air transport. The limitation of Regulation 1617/93 and its predecessors to consultation regarding fares within the EU did not reflect any inherent difference between interlining within the EU and interlining on services between the EU and third countries. This limitation was due rather to the restrictions on the Commission's enforcement jurisdiction prior to 1 May 2004. From the airline perspective, tariff consultation within the EU forms an integral part of a broader international interline system. An industry fare between two points in the EU is not only valid for transport on an interline itinerary within the EU. An intra-EU fare is also a key element in establishing industry fares for itineraries from the EU to third countries.<sup>13</sup> The artificial distinction between "intra-EU" and "EU-third country" interlining reflected in the Consultation Paper is a relic of the old regulatory regime. Under the modern regime, the issue can only be whether the multilateral interline system for traffic from points in the EU to any other point is consistent with Article 81 EC Treaty.

### **1.3 *The Economic Context for Assessing the Effects and Benefits of Interlining***

The Consultation Paper sets out an elaborate theoretical model charting traffic flows over rival hub systems as a basis for analysing the restrictive effects and benefits of tariff coordination and interlining. On the basis of this model, the Consultation Paper identifies *eleven* different categories of routes and seeks the views of commentators regarding the impact of interlining and/or tariff consultations in respect of the various categories that it has identified.

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<sup>12</sup> See Annex II, IATA Annex – Facts About the Economic Geography of Air Transport in the European Economic Area.

<sup>13</sup> Thus if a passenger wishes to go from Edinburgh to Kuala Lumpur and there is no IATA fare for that city pair, the Edinburgh-Frankfurt IATA fare could form an element in constructing a through fare on that itinerary. Likewise, even if there is an Edinburgh-Kuala Lumpur fare, the Edinburgh-Frankfurt fare may provide a basis for apportioning revenue to the airline flying that sector under some circumstances. Although the Consultation Paper recognizes that multilateral interlining to third countries outside the EU continues to generate benefits, it fails to see that prohibiting tariff consultations on fares within the EU will reduce those benefits. In this regard it is worth noting that there are 366 destinations within the EEA, or 1430 destinations on routes between the EEA and third countries for which there is an IATA fare.

IATA questions the utility of this theoretical model. It is clear that the irreducible benefits of the multilateral interline system manifest themselves on city pairs where no airline currently offers an “on-line” service. On other routes the importance of interlining, the benefits for airlines and passengers, and any notional restrictive effects will depend more on route-specific factors (such as the distance flown, the number of passengers, the number and nature of competitors, the viability of ground transport alternatives) than on the generic abstract factors underlying the Consultation Paper model.<sup>14</sup> Furthermore, the model ignores the interrelationship between the multilateral interline system and tariff consultations on any one city pair and the effective operation of the system for all other city pairs.<sup>15</sup> These two factors alone demonstrate that the model is far too simplistic and incomplete to form the basis of sound regulatory analysis.

## 2 Application of Article 81(1) to IATA Tariff Consultations on Passenger Fares

**2.1 Principles for Applying Article 81(1).** Assessment of IATA tariff consultations under Article 81(1) must be based on the following legal principles:

- An agreement or practice only has the “*object*” of restricting competition where experience shows that agreements or practices of this kind “have such a high potential” for “negative effects on competition that it is unnecessary [...] to demonstrate any actual effects on the market.”<sup>16</sup>
- An agreement only has the “*effect*” of restricting competition where it “affects actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation, or the variety and quality of goods can be expected with a reasonable degree of probability.”<sup>17</sup>

In previous consideration of IATA tariff conferences, DG Competition has asserted that tariff consultations may fall within Article 81 because they have the “object” of restricting competition.<sup>18</sup> The Consultation Paper, however, leaves this question open, basing application of Article 81 on the claimed restrictive “effect” of tariff consultations on competition. The assessment set out in the Consultation Paper is inconsistent with both economic theory and commercial reality. For the reasons set out below, there is no basis for

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<sup>14</sup> Any model that purports to provide a basis for empirical assessment of the benefits and costs of the interline system should be based on real airports and real traffic flows and not on abstract propositions regarding how passengers should behave. IATA would note that the model proposed by the Commission raises significant issues in this regard, particularly in respect of its “hub” definition which is at variance with the common industry understanding of what constitutes a hub airport. See further the discussion in Annex II.

<sup>15</sup> This is evident from the close relationship between the multilateral interline system and tariff consultations within the EU and the multilateral interline system as it affects traffic between the EU and third countries previously discussed. The reduction in transaction costs inherent in the substitution of multilateral consultations for bilateral consultations also increases with every route covered by the consultation.

<sup>16</sup> Commission Guidelines on Application of Article 81(3), point 21.

<sup>17</sup> *Id.*, point 24.

<sup>18</sup> See DG Competition Consultation Paper – IATA Passenger Tariff Conferences, February 2001, para. 22 where the DG Competition asserted that “There is no doubt that IATA passenger tariff conferences fall under Article 81 of the Treaty in that they lead to agreements between undertakings which restrict competition [...]”

concluding that tariff conferences have either the object or the effect of restricting competition within the meaning of Article 81.

**2.2. IATA Tariff Consultations do not have the “Object” of Restricting Competition.**

For external observers who are not familiar with the nature of the IATA process, the answer to this question is clear: (i) IATA member airlines are competitors; (ii) they meet together and discuss prices; (iii) these prices include those charged on routes where they compete; (iv) this constitutes “price-fixing”; (v) price-fixing is a classic form of conduct that has the object of restricting competition. This formalistic argument, however, ignores the economic function of the IATA tariff conferences and is inconsistent with the modern view of what constitutes a “restriction by object” for purposes of Article 81(1).

The economic function of IATA price discussions is to provide the basis for the multilateral product. This product is, by definition, a product that individual airlines cannot provide on their own. While the “carrier-specific” product offered by individual airlines, either alone or pursuant to a code-share agreement, may provide a partial substitute for the multilateral interline product, individual airlines cannot fully duplicate the range of alternatives and flexibility inherent in multilateral interlining. Moreover, IATA members do not discuss their own carrier-specific fares within IATA conferences, let alone reach agreement regarding the levels of those fares.<sup>19</sup> A classic price-fixing cartel, in contrast, involves either agreement by its members of the price at which they will sell their *own* products to customers or allocation between cartel members of customers, so that they need not offer competitive prices to those customers.<sup>20</sup> On this basis the tariff consultations within IATA do not fit the model of “price-fixing” that is condemned as inherently restrictive of competition.

This analysis is supported by the Commission’s own statements regarding the reasoning underlying the classification of certain arrangements as restrictive “by object”. The recent *Notice on Application of Article 81(3)* makes it clear that the category of restrictions by object is meant to cover those types of conduct where experience shows that agreements or practices of this kind “have such a high potential” for “negative effects on competition”.<sup>21</sup> While it is clear that agreements between competitors regarding the level at which they set

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<sup>19</sup> The position is different with respect to those routes to third countries where the relevant bilateral air service agreements *require* binding agreement of fares within an IATA structure. Enforcement of such agreements or adherence to an “official tariff” is a matter for the governments concerned and IATA has no role in ensuring or monitoring compliance with any such agreements. Any agreement of fares on those routes cannot be restrictive of competition for purposes of Article 81(1) to the extent that it is required by mandatory legal obligations, regardless of whether those legal obligations themselves may be subject to challenge under the EC Treaty, *see* Case T-504/93, *Tiercé Ladbroke v. Commission*, [1997] ECR II-923, §§ 30-35; T-387/94, *Asia Motors France v. Commission*, [1996] ECR II-961 § 61. If those bilateral air service agreements were changed, the consultations would then be limited to multilateral interlining and the points in this paragraph would be valid across the entire IATA system.

<sup>20</sup> It is not unusual for competitors to agree on prices for joint products that they cannot produce themselves, including in cases where the joint product is a partial substitute for the products sold by the parties to the agreement. Railpasses and multi-area ski passes are examples of such coordination. Likewise in cases where competitors form a joint venture to provide a common input or to produce a product that they cannot produce themselves, such arrangements have not generally been regarded as having the “object” of restricting competition, even though the joint venture members may have agreed on the prices charged by the joint venture (*see* Case No COMP/29.373 – *Visa International – Multilateral Interchange Fee* OJ [2002] L318/17; Case IV/32.437/8 – *Eurotunnel* OJ [1988] L311/36 and the discussion in the Legal Analysis in Annex I, p. 6-8).

<sup>21</sup> Commission Guidelines on Application of Article 81(3), point 21.



their prices for their own products have a high potential for raising prices or reducing output, the same cannot be said of agreements limited to discussing prices on a joint product.<sup>22</sup> These arrangements cannot therefore be evaluated on the basis that they automatically fall under Article 81 on a formalistic basis. The appropriate issue is therefore whether IATA tariff conferences have the *effect* of restricting competition in air transport markets.

**2.3 IATA Tariff Conferences do not have a Restrictive Effect on Competition.** The question of whether IATA tariff conferences have a restrictive effect on competition turns on whether “negative effects on prices, output, innovation, or the variety and quality of goods can be expected with a reasonable degree of probability.”<sup>23</sup> The Consultation Paper identifies two theories under which IATA tariff conferences could have such negative effects. The first theory relies on the “unavoidable consideration given by airlines to the coordinated level of IATA fares.”<sup>24</sup> The second theory is based on the assertion that IATA tariff conferences “provide a forum wherein airlines exchange information on costs, prices, and general industry developments” which (according to the Consultation Paper) reinforces the restrictive effects of tariff conferences.<sup>25</sup> IATA has commissioned Charles River Associates (“CRA”) to study these two theories from an economic perspective. The CRA report is annexed to this paper (Annex IV). The report concludes that neither of these theories provides a basis for finding a restrictive effect in air transport markets on the basis of theory or assumption alone. The reasons for this conclusion are summarized below.

The Consultation Paper’s theory on the “unavoidable consideration” give to IATA fares is based on the premise that “a pricing structure must in the long run remain coherent with the product offering it relates to and therefore adequately reflect product differentiation.”<sup>26</sup> This suggests that, since the airline’s own products are a differentiated partial substitute for the multilateral interline product, there must be a link between the IATA fare and the carrier-specific fare – an increase in one should lead to an increase in the other in order to maintain the “coherence” of the price structure. In other words the Commission’s legal theory appears to be that this inevitable link means there is always a restrictive effect and thus no need to conduct an economic analysis. The CRA report shows, however, that economic theory does not support this conclusion. On the contrary, economic theory demonstrates that there is no necessary link between the prices of partially differentiated products, particularly in conditions such as those that characterize air transport markets. On this basis the “coherent pricing structure/product differentiation” model cannot be relied on to show that IATA tariff conferences have a theoretical restrictive effect on competition between airlines.

The Consultation Paper’s information exchange theory must be understood by reference to the many cases decided by the Commission and the Community courts that consider the circumstances where exchange of confidential information between competitors may restrict competition for purposes of Article 81(1).<sup>27</sup> As these cases make clear, the restrictive effects

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<sup>22</sup> Indeed, the discussion in the section below suggests that there is no indication that consultation on fares within the IATA context is likely to have anti-competitive effects.

<sup>23</sup> Commission Guidelines on Application of Article 81(3), point 21.

<sup>24</sup> DG-COMP. Consultation Paper, para. 43.

<sup>25</sup> DG-COMP. Consultation Paper, para. 44.

<sup>26</sup> DG-COMP. Consultation Paper, para. 43.

<sup>27</sup> These cases are discussed in detail in the Legal Analysis in Annex I, p. 10.

of information exchange depends on the nature of the information exchanged, the manner in which it is exchanged, and the characteristics of the relevant markets. The key issue is ultimately whether the information exchange will facilitate collusion between participants. The CRA Report shows that such restrictive effects are inherently unlikely given the actual nature of information exchange in the IATA conference process and the dynamics of air transport markets.<sup>28</sup>

**2.4 Application of Article 81(1) – Conclusion.** The Consultation Paper has failed to identify a valid basis for concluding that the IATA multilateral interlining system, including the system of tariff conferences, is restrictive of competition for purposes of Article 81(1). The failure of the Consultation Paper to articulate a sustainable theory of restrictive effect is particularly significant. Even if Article 81(1) were deemed applicable on some formalistic basis, the lack of any quantifiable restrictive effects has significant implications for the analysis under Article 81(3).

### **3 Application of the Four Article 81(3) Requirements to IATA Passenger Tariff Coordination**

#### **3.1 Article 81(3) Applies to an “Agreement” or a “Practice”.**

As a preliminary matter it is important to note that Article 81(3) on its terms does not provide for clearance of discrete “restrictions of competition”. Article 81(3) provides instead for clearance of an agreement or practice. An enforcement agency or court applying Article 81(3) must therefore consider the restrictive effects and economic benefits of the agreement or practice as a whole, in the form presented by the parties to that agreement or practice. This is important in this case because, as already noted above, the IATA multilateral interline system forms an integrated whole. The only basis for the separate analysis of interlining and conferences within the EU and between the EU and third countries was the limitation on Commission jurisdiction that has now been removed. Under the new regulatory regime, the benefits and supposed restrictive effects of the IATA system must be assessed for the system as a whole, insofar as it affects trade within the EU.<sup>29</sup>

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<sup>28</sup> Annex V contains an IATA paper describing the manner in which IATA tariff conferences are conducted. As that paper shows, the IATA secretariat takes active steps to ensure that information exchange is limited to what is necessary for the consultation process and does not include competitively sensitive information. This steps include giving standard competition law warnings in conference documents and at conference meetings as well as making presentations on the competition law constraints that apply to the conferences. The paper also describes the matters actually discussed between airline representatives at IATA conferences. As the CRA paper in Annex IV concludes, these do not appear to involve matters that would give rise to anti-competitive effects.

<sup>29</sup> See also above, section 1.3 “Changes in the Commission’s Jurisdiction.” This assessment is consistent with the requirement that assessments be market-based, recognized in the paragraph 43 of the Commission *Notice on Application of Article 81(3)*, because of the close links between all affected air transport markets and the fact that the customer group that benefits is largely the same, regardless of the routes in question.

### 3.2 *First Article 81(3) Requirement – Economic Benefits*

*Applicable principles.* The first requirement of Article 81(3) is to show that the agreement or practice generates real “economic benefits” or “efficiency gains”.<sup>30</sup> The following principles are relevant to this assessment:

- The agreement must generate net benefits, *i.e.*, the benefits of the agreement as a whole must outweigh any restrictive effects identified in an Article 81(1) analysis. This requires a quantitative economic assessment.<sup>31</sup>
- Where there is no empirical showing of restrictive effects, any appreciable benefit that is associated with the agreement or practice will meet the requirements of Article 81(3).<sup>32</sup>
- Benefits must be “objective.” This means that they must be capable of quantification and verification. A product improvement for which customers are willing to pay a premium constitutes an objective benefit under this standard.<sup>33</sup>
- Where appreciable net benefits can be shown, the relative *significance* of the agreement or practice in the context of the markets affected is not relevant to application of the first requirement of Article 81(3).<sup>34</sup>

*Benefits of the IATA multilateral interline system.* IATA has asked CRA to perform an analysis of the benefits of the IATA system for EU consumers. CRA’s report is attached as Annex VI. During the limited period available for response to the Consultation Paper, it has not been possible to make a complete assessment of the range of benefits generated by the system. CRA’s preliminary analysis shows, however, that the benefits of the system continue to be substantial, both as regards traffic within the EU and as regards traffic from/to the EU to third countries.

The benefits identified by CRA fall into three categories:

- more convenient and lower cost services for connecting passengers
- flexibility, particularly for time-sensitive travellers
- reduced transaction costs for airlines that negotiate interline relationships

Based on the work done in the 2001 consultation exercise and the limited changes in the market structure since that time, the consumer benefits generated by interlining within the EU still exceed €200 million with the figure for both intra-EU traffic and traffic from the EU being in excess of €800 million.

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<sup>30</sup> The *Horizontal Guidelines* refer to this requirement as showing “economic benefits”, para. 32. The *Article 81(3) Notice* refers to this requirement as showing “efficiency gains”, para. 33.

<sup>31</sup> See Legal Analysis in Annex I, p. 12.

<sup>32</sup> See Legal Analysis in Annex I, *id.*

<sup>33</sup> See Legal Analysis in Annex I, p. 13.

<sup>34</sup> See Legal Analysis in Annex I, p. 12.

Three points should be noted in considering CRA's conclusions and applying the legal principles summarized above. The first is that this significant figure is particularly striking in the absence of any quantifiable level of consumer harm from the existing IATA system. The second point is that it does not matter whether the number of tickets sold at an interline tariff constitutes 50%, 5% or 0.5% of all tickets. If the benefits outweigh the restrictive effects, then the first requirement of Article 81(3) is satisfied. It is the existence of a measurable net benefit and not its relative level that is the key to assessing the IATA multilateral interline system under Article 81(3). The final point is that in assessing the value of flexibility inherent in an interlinable ticket, the relevant criterion can only be the number of tickets sold and the premium paid, not the number of times that customers "make use" of that flexibility. This reflects the fact that customers pay for the ability to change their plans, not for the change itself.<sup>35</sup>

On the basis of the above analysis, including CRA's evaluation, it is clear that the first requirement of Article 81(3) is satisfied.

### **3.3 *The Second Article 81(3) Requirement – Consumers Share in the Benefit***

*Legal principles.* The second requirement of Article 81(3) – that consumers share in the benefits identified in meeting the first requirement – is met where there is either a direct showing that agreements that lead to more product choice or lower prices for consumers or where the underlying markets are competitive, so that efficiencies achieved by producers will inevitably be passed on to their customers.<sup>36</sup>

*Application to the IATA Multilateral Interline System.* As regards this requirement, the Consultation Paper recognizes that insofar as the IATA system generates benefits, these are shared with consumers. The CRA paper also conclusively demonstrates that the benefits of the IATA system are direct contributions to consumer welfare including those benefits to airlines (*e.g.*, higher economies of density) which, due to the competitive characteristics of the airline industry, are passed onto EU consumers.

### **3.4 *The Third Article 81(3) Requirement – Restrictions Imposed on the Parties Must be "Indispensable" to Obtain the Benefits of the Agreement***

*Legal principles.* The third requirement of Article 81(3) requires that any "restrictions imposed on the undertakings concerned" in the agreement or practice be "indispensable" to achieving the benefits identified in meeting the first requirement. In considering this requirement it is important to note:

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<sup>35</sup> In the same way, the value of house insurance is set in the market by the willingness of consumers to buy it at a given price, not by the number of houses that are burgled or burnt down. Thus the data-gathering exercise instituted by the Commission following the last consultation exercise, insofar as it has attempted to gather information on the *use* of interlining or the *percentage* of tickets sold at an interline rate, is not strictly speaking relevant to the Article 81(3) assessment. The showing that substantial numbers of interline tickets are still sold though does support the CRA analysis of efficiency benefits.

<sup>36</sup> See Legal Analysis in Annex I, p. 13.

- This provision does not require a showing of proportionality between the benefits of an agreement and its overall restrictive effects.<sup>37</sup>
- This provision does not permit assessment of whether alternative arrangements that would result in lesser benefits would be preferable.<sup>38</sup>
- This provision does not permit assessment of whether *other* parties could create alternative arrangements that could duplicate or improve upon the benefits of the agreements or practices under consideration.<sup>39</sup>

*Application to the IATA multilateral interline system.* The complex analysis of this requirement in the Consultation Paper confuses a very simple question.<sup>40</sup> Since the principal restrictions of competition identified by the Commission derive from the IATA tariff conferences, the issue is whether the *full* benefits of IATA multilateral interlining identified by CRA could be generated if passenger tariff consultations could no longer take place. The answer to this question is clearly negative. IATA does not contend that the interline system would collapse, in the short term at least.<sup>41</sup> The elimination of tariff conferences, however, whether for all traffic or just for traffic EU-EU, would lead to higher prices for consumers, higher transaction costs for airlines, and a reduction in consumer choice. This follows because any alternative system, including the mix of “posted prices” and expanded code-share arrangements postulated in the Consultation Paper, will still leave some connecting city pairs without agreed through fares and will eliminate to a substantial degree the flexibility inherent in the IATA system, a feature that is clearly valued by passengers.<sup>42</sup>

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<sup>37</sup> As already noted above, the “proportionality” issue is properly dealt with in assessing whether an agreement generates net benefits under the first Article 81(3) requirement. The analysis in that context is, however, not a traditional “proportionality” analysis, but rather an economic assessment of the contribution of the agreement or practice to allocative efficiency or consumer welfare in the economic sense. *See* Legal Analysis in Annex I, p. 15.

<sup>38</sup> Thus the reference in the Consultation Paper to alternative systems that could generate the “bulk of existing benefit” is irrelevant to assessment under the indispensability test. *See* Legal Analysis in Annex I, p. 14.

<sup>39</sup> *See* Legal Analysis in Annex I, p. 15.

<sup>40</sup> This requirement of Article 81(3) arguably requires an examination of only those restrictions that are “imposed upon the undertakings concerned”. Read in this way, the IATA tariff conference system does not impose any restrictions on the undertakings concerned. In particular the airlines always remain free to charge whatever fare they choose including for tickets issued at IATA fares (but for which the passenger actually pays less than the IATA fare appearing on the ticket). This point has not been addressed in the Consultation Paper. While the correct interpretation of this requirement is an open issue, in this section we have focused on the restrictions the Commission claims arise out of the IATA tariff conference system.

<sup>41</sup> However, it is incontestable that removing the economic foundation of the system will reduce the incentive for airlines to maintain and improve the system. This point is particularly clear in the alliance-dominated world advocated in the Consultation Paper. The incentive for alliances will be to differentiate their respective brands through superior services rather than maintain or improve industry-wide systems.

<sup>42</sup> It will be noted that the alliance/posted-price alternative is not a less restrictive version of the present IATA system, but an entirely different set of arrangements. The possibility of instituting such a system is not relevant to assessing whether the “restrictions” associated with the IATA system are required to obtain the benefits generated by the IATA system (*see* Legal Analysis in Annex I, p. 15). In any case, it is doubtful that a posted-price system will emerge unless imposed by regulation. It may be noted in this regard that, although a posted-price system was mooted in the US as a basis for interlining when similar arrangements were reviewed in the 1970s – no posted-price system has emerged in the US. Similarly no posted-price system has emerged for intra-

### 3.5 *The fourth Article 81(3) Requirement – Competition should not be Eliminated*

*Legal Principles.* The fourth requirement of Article 81(3) – that the agreement or practice not “afford the possibility of eliminating competition” – applies only where there is a substantial prospect that effective competition on a significant relevant market will be eliminated *as a result of the agreement or practice*.

- This provision requires effects beyond the “negative effects on prices, output, innovation, or the variety and quality of goods” caught by Article 81(1) – it requires that competitive conditions deteriorate to the extent that there is no longer “effective competition” – *i.e.*, the parties to the agreement are no longer subject to competitive constraint from each other or from third parties – a market situation equivalent to joint or collective dominance.<sup>43</sup>
- This provision requires that there be a link between the agreement or practice and the lack of effective competition. Where the degree of competition is limited by other factors (*e.g.*, infrastructure constraints or government regulation) those limitations do not bar application of Article 81(3).<sup>44</sup>

*Application to the IATA multilateral interlining system.* The Consultation Paper suggests that there is a risk that IATA fare consultations could lead to elimination of competition on “hub-to-hub” routes within the EU. Apart from the fact that the Consultation Paper has not established the basis for identifying any significant restriction of competition at all, this assertion is puzzling to any observer familiar with the competitive position on the routes in question. It is hard to see how competition on routes such as London-Amsterdam, London-Frankfurt, or Frankfurt-Paris, can be described as anything other than competitive. There is certainly no risk that the – as yet unidentified – spillover effects of IATA tariff conferences could change that position.

### 3.6 *Application of Article 81(3) – Conclusion*

Based on the above, the arguments and the evidence supporting those arguments that the IATA multilateral interline system, including the IATA tariff conferences, continue to meet the requirements of Article 81(3) are overwhelming. This analysis leads to the conclusion, particularly in the absence of any credible theory of restrictive effects, that the IATA system does not violate Article 81.

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EU cargo interlining even though as discussed further below there is anecdotal evidence of non-EU carriers encountering difficulties in shipping to certain points in the EU (*see* below, p. 16).

<sup>43</sup> *See* Legal Analysis in Annex I, p. 16.

<sup>44</sup> This follows from the language of Article 81 itself, which refers to “any agreement [decision or concerted practice] ... which does not ... afford such undertakings the possibility of eliminating competition”. However, if the agreement makes the competitive situation in this market worse than it was before or makes it more difficult for competition to recover, this could lead to the application of this part of Article 81. *See* also Case 6/72 *Europemballage and Continental Can v Commission* [1973] ECR 215; Case T-7/93 *Langnese-Iglo v. Commission* ECR [1995] ECR II-1533.

## 4 Application of Article 81 to Cargo Rate Consultations

**4.1 Introduction – Special Features of Air Cargo Markets.** Although the application of Article 81 to cargo rate consultations presents many similar features to the analysis of passenger interlining set out above, the specific features of air cargo markets impact both the assessment of benefits and the identification of potential restrictive effects. Particular features of importance to an Article 81 analysis include the following:

- *Cargo markets are not based on city pairs.* In contrast to the position in respect of markets for passenger air transport services, the practice of the Commission has not been to analyse air cargo markets on a city-pair basis. This reflects the fact that connecting services are a full substitute for direct services on most cargo itineraries and that ground transport is often used as a substitute for air transport at either end of a cargo routing. On this basis the Commission has typically viewed cargo air transport in the EEA as a single market and identified air cargo to other world regions (e.g. EU-North America or EU-Far East) as distinct markets.
- *Cargo markets are highly competitive.* The competitive nature of cargo markets is indisputable. This in turn reflects a variety of factors including: the large number of competitors; the perishable nature of the product; the strength of a limited number of large customers (consolidators, freight forwarders, and large industrial firms).
- *Role of interlining in international air cargo.* The interline system for air cargo today has two principal functions. The primary function is to allow an airline to accept a shipment and issue a freight waybill for transport to an airport that the airline does not serve on-line. Issuing a through waybill is important for many routings because it avoids the need for the shipment to go through customs controls, security checks *etc.* at an intermediate airport. Thus for example, British Airways can accept a shipment in London for transport to an airport in Africa and issue a waybill to that destination, including trans-shipment at an intermediate point in Africa. The secondary function is to allow airlines to shift cargo to services of other airlines where for operational reasons the airline issuing the waybill is unable to transport the cargo itself. Thus, for example, if a shipment reaches an intermediate point and the ongoing flight is cancelled or delayed, or if available cargo space is blocked by need to accommodate a larger shipment, passenger baggage, or passenger load an airline may transfer the shipment to another carrier flying to the same destination. The IATA cargo tariff conference system is central to providing these functions on a multilateral and anytime/anyplace/any carrier basis.
- *Nature of interline shipments.* In principle, shipments of any size may be accepted on an interline basis and not just the “small shipments” (below 250 kg) category identified in the Consultation Paper. This will be the case particularly for long-haul destinations with limited on-line service. A major component of interline traffic, however, also involves high value, bespoke services (*e.g.*, transport of precious stones, banknotes, lottery tickets, human remains, live animals, dangerous goods or perishable foods) where timing, security and/or special services may be important.
- *Role of IATA rate consultations in facilitating cargo interlining.* The purpose of consultation on cargo rates is to establish the basis for the payment that the waybill-issuing carrier makes to the airline or airlines that participate in the shipment. Thus in the example of the British Airways shipment to Africa mentioned above, the second airline

would receive a prorata percentage of the IATA rate to the final airport (based on mileage and depending on the proportion of the final segment to the total distance of the service). Having a “pre-agreed” industry rate eliminates the need for an *ad hoc* bilateral negotiation of rates for an individual shipment or routing which may not take place if the IATA system was not in existence and saves the transaction costs associated with such negotiations where the shipment would justify the costs involved.

**4.2 Application of Article 81(1).** The general considerations set out above in respect to passenger tariff conferences apply equally to cargo rate-setting. Consultation on cargo rates does not have the *object* of restricting competition, since the sole purpose of rate-setting is to facilitate the provision of the interline product (other than where setting of rates within IATA is required by binding bilateral air services agreements and/or government regulation). As regards the issue of whether cargo rate consultations have the *effect* of restricting competition, the evidence is even more compelling than in the passenger sector. IATA has asked CRA to examine the relationship between cargo market rates and IATA industry rates over the last three years. CRA’s analysis (attached in Annex IV) shows that there is simply no meaningful link between the rates set in the market for non-interline traffic and the IATA rates.

**4.3 Application of Article 81(3).** The same basic considerations relevant to application of Article 81(3) in respect of passenger consultations apply in the context of cargo. In view of the superficial treatment of cargo consultations under Article 81(3) in the Consultation Paper, however, it is worth going into each of these requirements again in some detail.

**4.3.1 First Article 81(3) Requirement – Economic Benefits**

*Applicable principles.* The following principles are relevant to this assessment:

- The agreement must generate net benefits, *i.e.*, the benefits of the agreement as a whole must outweigh any restrictive effects identified in an Article 81(1) analysis. This requires a quantitative economic assessment.<sup>45</sup>
- Where there is no empirical evidence of restrictive effects, any appreciable benefit that is associated with the agreement or practice will meet the requirements of Article 81(3).<sup>46</sup>
- Benefits must be “objective.” This means that they must be capable of quantification and verification. A product improvement for which customers are willing to pay a premium constitutes an objective benefit under this standard.<sup>47</sup>
- Where appreciable net benefits can be shown, the *significance* of the agreement or practice in the context of the markets affected is not relevant to application of the first requirement of Article 81(3).<sup>48</sup>

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<sup>45</sup> See Legal Analysis in Annex I, p. 12.

<sup>46</sup> See Legal Analysis in Annex I, *id.*

<sup>47</sup> See Legal Analysis in Annex I, p. 13.

<sup>48</sup> See Legal Analysis in Annex I, p. 12.



*Benefits of Cargo consultations.* IATA has asked CRA to perform an analysis of the benefits of IATA cargo consultations for EU consumers (*see* Annex VI). The chief benefit is the elimination of the transaction cost that would be required for negotiating detailed bilateral deals (even with “alliance partners”) or for agreeing rates for individual shipments on an *ad hoc* basis. The second benefit relates to those smaller shipments where the transaction costs would outweigh the profit to the airline of accepting the shipment. In such cases, the lack of an interline product may deprive the consumer of an effective way of sending/obtaining a shipment. These benefits are modest but nonetheless appreciable.

In assessing these benefits, the following considerations are also relevant. First, these benefits must be assessed against the background of the lack of any demonstrable restrictive effects of the system. Second, even if the benefits are limited by comparison with the benefits of passenger tariff consultations, they are nonetheless real. Third, having demonstrated appreciable benefits, it is irrelevant what percentage of cargo shipments travel on an interline basis. Finally, the benefits of rate coordination in the EU and from the EU to third countries are linked. Thus today, where there are no industry standard rates in the EU, anecdotal evidence suggests that shippers have suffered delays and higher costs in arranging shipments to EEA points that are not served on-line from the point of shipment and where IATA rates may not exist, because rates for onward shipment within the EU must be arranged on an *ad hoc* basis. Ultimately, of course, these higher costs are borne by the firms receiving the shipments in the EEA. Furthermore, for a number of carriers based in the EU the absence of industry rates eliminates the opportunity to compete for shipments for points beyond their gateways or trucking operations due to the prohibitive cost of *ad hoc* combined rates or the prohibitive transaction costs in arranging the shipment.

#### **4.3.2            *The Second Article 81(3) Requirement – Consumers Share in the Benefit***

*Legal principles.* The second requirement of Article 81(3) – that consumers share in the benefits identified in meeting the first requirement – is met where there is either a direct showing that agreements that lead to more product choice or lower prices for consumers or where the underlying markets are competitive, so that efficiencies achieved by producers will inevitably be passed on to their customers.<sup>49</sup>

*Application to cargo consultations.* The benefits described above are clearly shared with consumers. The reduction in transaction costs generally is shared with consumers given the competitiveness of air cargo markets. Furthermore, where a more cumbersome system gives rise to transaction-specific costs (as in an *ad hoc* rate negotiation or where a shipper is unable to deal with a single entity for all its shipments due to the inability of airlines to quote through rates for destinations not served), that cost will generally be passed on to consumers, so consumers benefit by eliminating such costs. Finally, for small or one-off shipments where transaction costs might otherwise eliminate the interline option, there is a direct consumer benefit – if the availability of an interline option allows for transport of the remains of a deceased family member or allows that transport to take place a day earlier than would otherwise be possible, the benefits are very real, even if they cannot be fully quantified.

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<sup>49</sup> *See* Legal Analysis in Annex I, p. 13.

**4.3.3      *The Third Article 81(3) Requirement – Restrictions Imposed on the Parties Must be “Indispensable” to obtain the Benefits of the Agreement***

*Legal principles.* The third requirement of Article 81(3) requires that any “restrictions imposed on the undertakings concerned” in the agreement or practice be “indispensable” to achieving the benefits identified in meeting the first requirement. In considering this requirement it is important to note:

- This provision does not require a showing of proportionality between the benefits of an agreement and its overall restrictive effects.<sup>50</sup>
- This provision does not permit assessment of whether alternative arrangements that would result in lesser benefits would be preferable.<sup>51</sup>
- This provision does not permit assessment of whether *other* parties could create alternative arrangements that could duplicate or improve upon the benefits of the agreements or practices under consideration.<sup>52</sup>

*Application to cargo interlining.* The Consultation Paper suggests that since the benefits of cargo interlining focus primarily on smaller shipments (under 250 kg), these arrangements are not really “indispensable” since shippers could use express cargo/courier services such as Federal Express, DHL, or UPS. This analysis is both mistaken in its application of the law and wrong in its understanding of the way the market operates.<sup>53</sup>

As regards the legal test, the key point is that the availability of alternative products by other vendors has never been regarded as relevant to the indispensability test.<sup>54</sup> The issue is whether restrictions are indispensable for the benefits of the agreement under consideration.

Concerning the facts and how the market operates, it is simply not correct that the express/courier companies offer a complete substitute for the needs of shippers using interline services. Express and courier companies do not generally accept consignments which require special handling, special services or special customs clearance requirements such as human remains, valuable cargo, perishables, live animals or dangerous goods. Furthermore, even on the analysis of the Consultation Paper, they are not suited to deal with the larger shipments that are also shipped on an interline basis. It is also instructive to note that the courier/express companies are both important customers for airport-to-airport air cargo services, and in some markets offer airport-to-airport services. In this context these companies both purchase services on an interline basis and provide services on an interline basis.

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<sup>50</sup> See Legal Analysis in Annex I, p. 15.

<sup>51</sup> See Legal Analysis in Annex I, p. 14.

<sup>52</sup> See Legal Analysis in Annex I, p. 15.

<sup>53</sup> See CRA analysis in Annex VI and Legal Analysis in Annex I, p. 14-15.

<sup>54</sup> Thus in assessing a joint venture to manufacture a “people carrier” vehicle, the Commission did not consider whether similar vehicles produced by, for example, Renault or Daimler Chrysler were sufficient to meet consumer needs. See Legal Analysis in Annex I, p. 15.

The real question here is simple. If cargo rate consultations are eliminated, can the full benefits of the present interline system be maintained? The answer is equally simple. Eliminating cargo rate consultations will lead to higher transaction costs and direct costs to consumers – thus consultations *are* indispensable to obtain the full benefits of the present system.

#### **4.3.4      *The fourth Article 81(3) Requirement – Competition should not be Eliminated***

*Legal Principles.* The fourth requirement of Article 81(3) – that the agreement or practice not “afford the possibility of eliminating competition” – applies only where there is a substantial prospect that effective competition on a significant relevant market will be eliminated *as a result of the agreement or practice*.

- This provision requires effects beyond the “negative effects on prices, output, innovation, or the variety and quality of goods” caught by Article 81(1) – *i.e.*, the parties to the agreement are no longer subject to competitive constraint from each other or from third parties – a market situation equivalent to joint or collective dominance.<sup>55</sup>
- This provision requires that there be a link between the agreement or practice and the lack of effective competition. Where the degree of competition is limited by other factors (*e.g.*, infrastructure constraints or government regulation) those limitations do not bar application of Article 81(3).<sup>56</sup>

*Application to IATA cargo rate consultations.* In light of the competitive nature of worldwide air cargo markets, in a context where tariff rate consultations remain in place for traffic between the EU and third countries, there is no serious risk that continuing these consultations could eliminate competition on a significant market in the EU.

## **5 Why is an Article 81(3) Regulation Appropriate?**

IATA has demonstrated above the reasons why the IATA multilateral interline system for both passengers and cargo is clearly compatible with the requirements of Article 81. In light of the strength of these arguments and the general shift to “self assessment” under the new EU enforcement regime, it may legitimately be asked why an industry-specific regulation remains appropriate. In order to answer this question it is necessary to consider the role of Article 81(3) regulations in the post-modernization environment.

### **5.1      *The Role of an Article 81(3) Regulation in the Post-Modernization Environment***

Under the “old regime”, block exemption regulations performed an important function by making individual notifications for exemption under Article 81(3) unnecessary. This

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<sup>55</sup> See Legal Analysis in Annex I, p. 16.

<sup>56</sup> This follows from the language of Article 81 itself, which refers to “any agreement [decision or concerted practice] ... which does not ... afford such undertakings the possibility of eliminating competition”. However, if the agreement makes the competitive situation in this market worse than it was before or makes it more difficult for competition to recover, this could lead to the application of this part of Article 81. See also Case 6/72 *Europemballage and Continental Can v Commission* [1973] ECR 215; Case T-7/93 *Langnese-Iglo v. Commission* ECR [1995] ECR II-1533.

provided benefits for both the parties to agreements and to the Commission by reducing the transaction costs associated with the filing and review of notifications. The role of an Article 81(3) regulation in the post-modernization environment is clearly different.<sup>57</sup> The primary purpose of such regulations is to provide a “safe harbour” for arrangements that are already either outside Article 81(1) or allowed under Article 81(3).<sup>58</sup>

In light of these changes, Article 81(3) regulations should be appropriate where one or more of the following conditions are met:

- There is genuine uncertainty regarding the application of Article 81 to agreements or other cooperative activities.
- The agreements or practices involve a substantial number of firms.
- An *ad hoc* self-assessment exercise by each firm involved in the agreements or practices will generate substantial costs, which may impose an unreasonable burden on some of these firms.
- The agreements or practices involve all or a substantial part of an important industry.
- The regulation serves important interests of the EU or of Member States (*e.g.*, in relations with third countries).

Furthermore, where an existing block exemption is in place, market expectations may dictate a presumption that a regulation remain appropriate, unless there has been a substantial change of circumstances that make Article 81(3) no longer applicable, since terminating a regulation could prejudice a subsequent self-assessment exercise.

## **5.2 Application to IATA Tariff Coordination.**

The 128 members of IATA that participate in IATA Passenger Tariff Conferences and the 95 that participate in the Cargo Tariff Conferences vary enormously in size and sophistication. While large EU-based airlines can be expected to have a sophisticated understanding of EU competition law, and are capable of commissioning their own self-assessment exercise, smaller airlines or airlines with limited services to the EU are in a different position. Furthermore, even large airlines from countries with a different competition law tradition are reluctant to accept differences in legal assessment in the EU on a pure self-assessment basis. The value of an Article 81(3) regulation to the industry as a safe harbour in this regard is very substantial.<sup>59</sup>

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<sup>57</sup> For these purposes the “post-modernization” environment began for vertical agreements with the elimination of the notification requirement in 1999.

<sup>58</sup> This is evidenced by both the modern block exemption for vertical agreements and by the recently issued block exemption for technology transfer agreements. In each case the regulation creates a “safe harbour.” In each case a careful reading of the accompanying guidelines reveal that many of the “restrictions” exempted under the regulation, actually fall outside Article 81(1) altogether.

<sup>59</sup> It should be noted that, in addition to the 128 Tariff Conference members, a large number of other airlines participate in the interline system without being Tariff Conference members or even IATA members. The system is facilitative in allowing any airline to participate without obligation. It is not a restricted club and many airlines will accept, and issue an industry fare for interline journeys.

Secondly, as the Consultation Paper recognizes, the importance of clarifying the impact of competition rules on the multilateral interline system has been the subject of a resolution in ICAO.<sup>60</sup> It is known to be a concern to governments of countries outside the EU. Under these circumstances, maintaining an Article 81(3) regulation for IATA tariff consultations performs an important function for third-country relations on the part of both the EU and of EU Member States.

Thirdly, Regulation 1617/93 is in place. As the substantive discussion above shows, there have been no material changes in circumstances that would justify its revocation. On the contrary, the expansion in Commission jurisdiction to cover air traffic to third countries makes the continuation of a regulation covering IATA tariff conferences far more important.

Finally, a self-assessment exercise of IATA tariff conferences cannot provide sufficient comfort for IATA and IATA member airlines due to the legal uncertainty introduced by DG Competition. This legal uncertainty has resulted from the combination of terminating the Article 81(3) regulation applicable to intra-EEA cargo tariff conferences, initiating proceedings under Article 81(1) against such conferences, and positions taken in the current Consultation Paper. These actions combine to cast a cloud over the IATA multilateral interline system even though this system is fully consistent with Article 81 for the reasons set out in this response. Furthermore, the public statements associated with this consultation could have an influence on courts and competition authorities both within and outside the EU. Under these circumstances an Article 81(3) regulation is an appropriate tool for eliminating the uncertainty.

## CONCLUSION

The analysis set out above conclusively demonstrates that IATA tariff conferences for passenger and for cargo have neither the object nor effect of creating an appreciable restriction on competition. The analysis also demonstrates that the conferences create substantial benefits for consumers in a way that clearly qualifies for the application of Article 81(3). There is therefore no reason to terminate the existing regulation applying to such conferences for passenger tariffs within the EEA. Instead the regulation should be extended to apply to passenger tariff conferences concerning travel between the EEA and third countries as well as to cargo tariff conferences concerning air freight between the EEA and third countries.

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<sup>60</sup> Consolidated Conclusions, Model Clauses, Recommendations and Declaration of ATConf/5, Agenda Item 2.3 - Fair competition and safeguards, paragraph e). See full text of the conclusions at: [http://www.icao.int/icao/en/atb/atconf5/docs/ATConf5\\_conclusions\\_en.pdf](http://www.icao.int/icao/en/atb/atconf5/docs/ATConf5_conclusions_en.pdf). Both the European Community and the European Commission were among the participants in the ICAO 5<sup>th</sup> Worldwide Air Transport Conference that adopted this conclusion.



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**ANNEX I**

**COMMENTS OF IATA ON  
DG COMPETITION CONSULTATION PAPER CONCERNING  
REGULATION 1617/93**

**THE LEGAL CONTEXT FOR ASSESSING IATA TARIFF  
CONFERENCES**

The purpose of this paper is to explain the legal analysis supporting IATA's Comments on the Consultation Paper. This paper addresses the following issues:

- *Why does IATA fare consultation not have the “object” of restricting competition for purposes of Article 81(1)?* This paper shows that, because IATA fare consultations are limited to determining the price of a joint product that individual airlines cannot offer on their own – it does not involve the “fixing” of the price of individual airline's own products that they market in competition with each other.
- *Why does IATA fare consultation not have the “effect” of restricting competition for purposes of Article 81(1)?* This paper shows that the modern view of Article 81(1) defines a restrictive “effect” on competition as an appreciable increase in prices or reduction in output in a relevant market. Contrary to the assertion in the Consultation Paper, there is no evidence that IATA tariff consultations have any such effect on the prices charged by individual airlines for their own products.
- *Why does IATA fare consultation clearly satisfy the standards for applying Article 81(3) to IATA tariff consultations?* This paper shows that the Consultation Paper has incorrectly understood the legal test under Article 81(3), particularly in respect of “indispensability”, and “elimination of competition”. Applying the proper legal test there is no legal issue regarding the applicability of Article 81(3) to the IATA system.
- *Does the current IATA interlining system correspond with the requirements of Regulation 1617/93?* This paper shows that the concerns expressed in the Consultation Paper regarding the compliance of the IATA Multilateral Interline System with the current Article 81(3) Regulation are misplaced.

As background for this discussion, this paper starts by considering the evolving legal context in which the IATA conference system has developed and must be assessed. The rethinking of Commission competition policy under Article 81 over the last seven years has important implications for the assessment of the IATA interline system. In 1987 there was little doubt that the IATA system in its then current form, required an Article 81(3) exemption to function. Today by contrast, the modern economics-based approach to Article 81, in combination with the evolution of the IATA system and changes in airline markets, means that the automatic assumption that Article 81 is applicable is no longer valid. The lack of any demonstrable anti-competitive effects also means that there can be no serious issue regarding the net benefits of the IATA system should it be necessary to apply Article 81(3).

## **1. The IATA Multilateral System and the Evolution of EU Competition Law**

*The effects of air transport liberalization on application of Article 81 to tariff consultations.* Prior to 1987, IATA and its Tariff Conferences operated largely outside the European competition law structure. Regulation 141/62 “carved out” agreements regarding price-setting for transport services from the Commission's general competition law enforcement powers under Regulation 17/62. While the Commission and Member State authorities retained residual enforcement powers under Articles 84 and 85,<sup>1</sup> the activities of IATA did

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<sup>1</sup> All references to Treaty provisions are to current numbering.

not come under serious scrutiny in Europe.<sup>2</sup> Furthermore, since IATA activities in Europe took place in the context of legal requirements regarding agreement on fare levels and filings (implementing bilateral Air Service Agreements between the countries concerned), the application of Article 81 was questionable in light of the regulatory regime then in place.

The position changed with the adoption of the first air transport liberalisation package in 1987 as far as intra-Community travel was concerned. The first package relaxed the legal restrictions on fare-setting and fare filing within the Community. The first package also included Council regulations extending the direct enforcement jurisdiction of the Commission under Articles 81 and 82 to cover air transport between Member States<sup>3</sup> and empowering the Commission to issue block exemption regulations covering specified categories of agreements or concerted practices in the air transport sector.<sup>4</sup> This latter regulation specifically authorized the Commission to issue an exemption regulation in respect of passenger and cargo tariff consultations and the Commission duly issued Regulation 2671/88.

When Regulation 2671/88 was issued, the applicability of Article 81 to the IATA tariff conference structure was not in serious doubt. This reflected (i) the nature of the IATA process prior to 1987; (ii) the nature of airline competition in the immediate aftermath of liberalization; and (iii) the formalistic approach that dominated the Commission's legal assessment under Article 81 until the late 1990s.

*The "old" IATA process and Article 81.* A fundamental reason for applying Article 81 to IATA tariff consultations through the Regulation 2671/88 exemption in 1988 was that, prior to that time, IATA conference discussions *did* quite openly involve mandatory fixing of prices for air transport services within the Community. These discussions covered the full fare package that was submitted to the relevant air transport regulators for approval. IATA and its members maintained that these practices served valid consumer interests, but it was not seriously suggested that these agreements did not limit competition between the participants where they were not mandated by the applicable regulatory provisions. Given the continuity between the pre-1987 and post-1987 arrangements, the likelihood that consultations would give rise to binding fare-setting agreements, absent specific legal restrictions, played a role in justifying application of Article 81.

*Post-liberalisation airline markets and application of Article 81.* A second reason for the general acceptance in 1988 that Article 81 was applicable involved the slow evolution of liberalization in the market. In 1988 and for a number of years thereafter, the legacy effect of the old system was still evident in many EU air transport markets. It was not unusual for airlines to mirror the IATA fares in their own "full fare" products. The plethora of airline-specific fares and other elements of a competitive market (*e.g.*, widespread corporate discount agreements, competition from low-cost carriers) that exist today were simply not

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<sup>2</sup> In Joined Cases 209-213/84 *Ministère Public v. Lucas Asjes* [1986] ECR 1425, the Court of Justice ruled that Member State legislation that prohibited sales of air transport products below the agreed tariff could not be challenged because Article 81 did not have direct effect.

<sup>3</sup> Council Regulation (EEC) No 3975/87 of 14 December 1987 laying down the procedure for the application of the rules on competition to undertakings in the air transport sector OJ [1987] L 374/1.

<sup>4</sup> Council Regulation (EEC) No 3976/87 of 14 December 1987 on the application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices in the air transport sector OJ [1987] L 374/9.



present. The existence of a “coat-hanger” effect in the early years of liberalization could thus readily be posited as a reason for applying Article 81 to the IATA system.

*Legal Formalism and the Application of Article 81 to the IATA System.* Under the “Old Regime” the concept of a “restriction of competition” as understood by the Commission related to any agreement or understanding that limited the autonomy of a firm in its commercial decision-making.<sup>5</sup> This identification of “competition” with the competitive activity of an individual firm led to a formalistic approach to Article 81.<sup>6</sup> An agreement had the “object” of restricting competition, where its clear purpose was to limit the autonomy of a firm in respect of a significant parameter of competition. An agreement had the “effect” of restricting competition where it could result in an appreciable shift in the shares of market players – a 10% or even 5% shift might be sufficient. Furthermore, the emphasis on formalistic appraisal meant that agreements could be classified as restrictive based on external characteristics without a thorough examination of market conditions. (Thus agreements “related to” price, customers, or territories, were routinely condemned without reference to actual effects.)

The 1992 Commission decision in *Aer Lingus/British Midland*, cited in the Consultation Paper, is characteristic of the formalistic approach. In that case the Commission described the discussion of developments in operating costs by airlines within the framework of an IATA Tariff Conference as an: “[...] exchange of information on airline costs and tariff objectives with a view to preparing a common position on passengers' fares and cargo rates [that] constitutes an agreement, or at least a concerted practice between undertakings, by which they coordinate their pricing decisions” and, without any analysis of their effects, went on to conclude that “[t]ariff consultations are therefore a restriction of competition as contemplated by Article 85 (1).”<sup>7</sup>

*Modernization and the Economic Approach to Article 81.* Since the late 1990s, the Commission’s approach to Article 81 has undergone radical change.<sup>8</sup> In place of the old formalistic approach, the modern approach puts the emphasis on economic assessment. A “restriction of competition” is no longer viewed as a limitation on competitive autonomy, but rather as a reduction in the competitive functioning of the market – an increase in prices or

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<sup>5</sup> Consider for example the language of Section 4.2 in the old Form A/B (used to notify agreements under Regulation 17/62) which requested parties to agreements to detail “any provisions contained in the agreements which may restrict the parties in their freedom to take independent commercial decisions”. Commission Regulation (EC) 3385/94 of 21 December 1994 on the form, content and other details of applications provided for in Council Regulation No. 17/62 OJ [1994] L 377/28.

<sup>6</sup> See e.g. Richard Whish, “Competition Law”, LexisNexis Butterworths, Fifth Edition, at p. 107; Claus-Dieter Ehlermann, “The Modernization of EC Antitrust Policy: A Legal and Cultural Revolution”, [2000] C.M.L.Rev. 537 at 548.

<sup>7</sup> Case No. IV/33.544, *British Midland v. Aer Lingus*, OJ [1992] L96/34, at Recital 33.

<sup>8</sup> See e.g. Céline Gauer, Lars Kjølbye, Dorothe Dalheimer, Eddy de Smitjter, Dominik Schicels and Maija Laurila, “Regulation 1/2003 and the Modernisation Package fully applicable since 1 May 2004”, Competition Policy Newsletter Summer 2004, at p. 5: “It is important to keep in mind that in recent years the application of the prohibition rule of Article 81(1) has been re-thought considerably. [...] Plaintiffs and enforcers have to make a real case under Article 81(1) [...] based on sound economic principles.”

See also Mario Monti, “EU Competition Policy after May 2004”, speech at the Fordham Annual Conference on International Antitrust Law and Policy, October 24, 2003, p. 4-6.

limitation on output or consumer choice. In contrast to the previous policy, the Commission's Horizontal Guidelines<sup>9</sup> now state that:

“[m]any horizontal cooperation agreements [...] do not have as their object a restriction of competition. Therefore an analysis of the effects of the agreement is necessary. For this analysis it is not sufficient that the agreement limits competition between the parties. It must also be likely to affect competition in the market to such an extent that negative market effects as to prices, output, innovation, or the variety or quality of goods or services can be expected.”<sup>10</sup>

The Commission's new economics-based approach is reflected in its recent Guidelines on the application of Article 81(3) of the Treaty (“Article 81(3) Guidelines”).<sup>11</sup> The Article 81(3) Guidelines confirm that the objective of Article 81 is to “protect competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources.”<sup>12</sup> The assessment of whether or not an agreement is restrictive of competition must therefore not be made on any formalistic basis but rather within the actual context in which competition would occur in the absence of the agreement with its alleged restrictions.<sup>13</sup>

*IATA Fare Consultations, the modern approach to Article 81, and a highly competitive air transport market.* The reasons that led in 1988 to a presumption that Article 81 was applicable are no longer valid in 2004. The days when IATA in the EU could be described as a classic price-fixing cartel are long over – instead as the CRA paper in Annex II demonstrates, IATA scrupulously maintains procedures that focus conferences on the legitimate aim of creating interlinable fares, without overflow to airline-specific fares or exchange of otherwise sensitive information. The airline market has evolved in a way that could scarcely be imagined in 1988 – the wide variety of airline-specific fares that are available and the range of competitive alternatives for many routings, means that there is no basis for assuming a relationship between IATA fares and other fares in the market. The economic context for IATA conferences today, viewed in light of the modern economics-based approach to Article 81, requires a fundamental reassessment of the application of Article 81 but there is not recognition of these changes or their implications in the Consultation Paper. The basis for this fundamental reassessment of the application of Article 81 to IATA conferences is set out below.

## **2. Does the Operation of IATA Tariff Conferences have the “Object” of Restricting Competition for Purposes of Article 81(1) EC?**

The Consultation Paper does not take a position on the legal question of whether IATA tariff consultations have the “object” of restricting competition in airline markets.<sup>14</sup> The

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<sup>9</sup> Commission Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements OJ [2000] C291/1.

<sup>10</sup> Horizontal Guidelines, para. 19. See also Case T-112/99, *Métropole Télévision (M6) and others* [2001] ECR II-2459, at paras. 76-77.

<sup>11</sup> Commission Guidelines on the application of Article 81(3) of the Treaty OJ [2004] C101/97.

<sup>12</sup> Article 81(3) Guidelines, para. 13.

<sup>13</sup> Article 81(3) Guidelines, para. 17.

<sup>14</sup> The Consultation Paper states that its analysis of restrictive effects is “without prejudice” to this “legal question” at para. 43.

Commission has, however, previously asserted that IATA Tariff Conferences do have the object of restricting competition and the Consultation Paper cites a previous Commission decision that apparently found that consultations had an anti-competitive “object.” Furthermore it is possible that this legal issue could be raised by other participants in the consultation process. The issue of “competitive object” is therefore addressed to provide full treatment of the significant issues raised in the consultation.

*Restrictions by “Object” – the modern approach.* Restrictions of competition by object are those that are presumed in light of the objectives pursued by the Community competition rules to have such a high potential of negative effects on competition that it is unnecessary for the purposes of applying Article 81(1) to demonstrate any actual effects on the market.<sup>15</sup> This presumption is based on experience showing that they are likely to produce negative effects on the market and to jeopardise the objectives pursued by the Community competition rules.<sup>16</sup> The assessment of whether or not an agreement has as its object the restriction of competition is based on a number of factors. These factors include, in particular, the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which it is (to be) applied and the actual conduct and behaviour of the parties on the market. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction of competition by object.<sup>17</sup>

*What constitutes “price-fixing” under the modern approach?* The Commission has described “price fixing” as an example of a restriction by object which reduces output and raises prices. Price-fixing leads to a misallocation of resources, because goods and services demanded by customers are not produced, and a reduction in consumer welfare, because consumers have to pay higher prices for the goods and services in question.<sup>18</sup> The presumption that price-fixing is restrictive is also reflected in Article 81(1)(a) which defines agreements which directly or indirectly fix purchase or selling prices or any other trading conditions as an example of a restriction of competition.<sup>19</sup>

The Commission has, however, acknowledged that discussion or agreement on prices does not always equate with the hard core restriction of “price-fixing”. For example, it is clear that the presumption of restrictive effects may not apply in the case of a production joint venture. It is inherent to the functioning of such a joint venture that decisions on output and prices (where joint marketing of the joint products also takes place) need to be taken jointly by the parties to such an agreement. In this case, the inclusion of provisions on prices or output does not automatically cause the agreement to fall under Article 81(1). The provisions on prices or output need to be assessed together with the other effects of the joint venture on the market to determine the applicability of Article 81(1).<sup>20</sup>

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<sup>15</sup> Article 81(3) Guidelines, para. 21.

<sup>16</sup> Article 81(3) Guidelines, para. 21.

<sup>17</sup> Article 81(3) Guidelines, para. 22.

<sup>18</sup> Article 81(3) Guidelines, para. 21.

<sup>19</sup> See also Horizontal Guidelines, para. 25 (suggesting that it can be *presumed* that price fixing has negative market effects and is almost always prohibited under Article 81(1)).

<sup>20</sup> Horizontal Guidelines, fn. 18.

A good example of this approach is the Commission's decision in *Visa International – Multilateral Interchange Fee*.<sup>21</sup> In that case, the Commission concluded that an agreement between the banks involved in the Visa multilateral payment system to set the level of the "Multilateral Interchange Fee" did restrict the freedom of the banks individually to set their own pricing policies. The Commission did not, however, consider the agreement to be a restriction of competition *by object*, even though it involved the joint setting of prices. The Commission ruled that the agreement did not have an anti-competitive object since its primary purpose was to increase the stability and efficiency of operation of the Visa payment system.

The *Visa* case follows a line of cases where the Commission or the Court has dealt with alleged restrictions that are "ancillary" to agreements that are intended to create benefits such as the creation of new products. Under these circumstances, provisions that might otherwise be "hard core" restrictions – restrictive by object – are caught by Article 81(1) only if they have a restrictive effect on competition.<sup>22</sup> The approach taken by the Commission in the recent Technology Transfer Block Exemption and related guidelines is a further example of this line of reasoning.<sup>23</sup> In the context of technology licensing the Commission has clearly equated the "object" of restricting competition with the existence of a hard core restraint,<sup>24</sup> while restraints that are "welfare-enhancing" are not treated as hard core and are subject to an effects analysis, even when they involve otherwise hard core restrictions like customer or territorial allocation.<sup>25</sup>

On this basis, the modern view of "price fixing" as a hard core restraint can be summarized as follows. There is a presumption that agreements between competitors regarding the price that each charges for its own products is anti-competitive. Where discussions on prices take part in the context of production of a joint product, however, there is no such presumption, particularly where the "competitors" could not produce the product or service in question on their own.

*IATA airlines are not "competitors" in respect of the multilateral interline product.* Even under a formalistic view of price-fixing, consultation on interline fares would not constitute "price-fixing" since price-fixing implies an agreement on prices between competitors in

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<sup>21</sup> Case No COMP/29.373, OJ [2002] L318/17.

<sup>22</sup> See also Opinion of Advocate General Tesauro in Case C250/92 *Gottrup-Klim, Grovvefareforeninger v. Dansk Landbrugs Grovvarselkab AmbA* [1994] ECR I-5641; Case C-306/96 *Javico International and Javico AG v. Yves Saint Laurent Parfums SA* [1998] ECR I-1983; Case 161/84 *Pronuptia de Paris GmbH v. Irmgard Schillgallis* [1986] ECR 353; Case C-110 & 241-242/88 *Lucazeau v. SACEM* [1989] ECR 2811. It should also be remembered that IATA Tariff Conferences do not have any of the typical hallmarks of "hard core" cartels in that the Conferences do not take place in secret and government observers are welcome to attend and receive copies of all minutes *etc.*

<sup>23</sup> Commission Regulation (EC) No 772/2004 on the application of Article 81(3) to categories of technology transfer agreements OJ [2004] L123/11. Commission Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements OJ [2004] C101/2 ("Technology Guidelines").

<sup>24</sup> See *e.g.* Technology Guidelines, para. 74.

<sup>25</sup> See *e.g.* Technology Transfer Block Exemption, Article 4(1)(c)(i) and Technology Guidelines, para. 90 (exemption of field of use restrictions that would otherwise constitute "hard core" allocation of markets or customers between competitors).

respect of their individual products.<sup>26</sup> It is, however, well established that agreements having as their sole object the setting up of consortia for the joint execution of orders, where each of them by itself is unable to execute the orders, do not restrict competition.<sup>27</sup>

This rule applies both to enterprises belonging to different industries and to firms in the same industry to the extent that their contribution under the consortium consists only of goods or services which cannot be supplied by the other participating enterprises. But even in the case of consortia formed by enterprises which normally compete with each other, there is no restraint of competition if the participating enterprises cannot execute a specific order by themselves.<sup>28</sup> Moreover, it is also accepted that, where agreements are designed to enable the joint production and decentralized sale of complex services worldwide, it may be necessary to set out pricing guidelines to maintain the *coherence and integrity* of the worldwide service being provided.<sup>29</sup>

On this basis consultations designed to allow the sale by airlines of the multilateral interline product are not discussions between competitors for that purpose. The multilateral interline product is a product that no airline can provide on its own.<sup>30</sup> The fact that the multilateral product may be a partial substitute for some customers and thus part of a broader market where airlines do compete with each other is not relevant. In the absence of a demonstrable spillover effect (discussed in the next section), there is no restriction of competition.

*Conclusion.* It is evident that IATA Tariff Conferences cannot be deemed to have the object of restricting competition:

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<sup>26</sup> The fact that individual carriers may choose to offer post-facto discounts on IATA interlinable fares where a corporate customer actually uses the services of the airline concerned does not alter this analysis or somehow transform the joint IATA interlinable product into a product that each airline competes in selling. Furthermore, the purpose of the tariff conferences is to set the IATA fare/rate, the airlines are free to offer discounts as they see fit (except where such discounting may be prohibited under a bilateral Air Service Agreement or other applicable government regulation but such restrictions, where they exist, do not originate in nor are enforced in the context of the IATA system).

<sup>27</sup> See e.g. Notice concerning agreements, decisions and concerted practices in the field of cooperation between enterprises, II. 5 OJ [1968] L75/3; see also Stockmann in Wiedemann, Handbuch des Kartellrechts, § 8, 259-260.

<sup>28</sup> Case IV/32.437/8 – *Eurotunnel* OJ [1988] L311/36, Recital (17). See also Haag in von der Groeben/Schwarze, Kommentar zum EU/EG-Vertrag, nach Artikel 81 EG – Fallgruppen / Kooperationsabsprachen, 63; Stockmann, *ibid.*

<sup>29</sup> See Case IV/35.518 - *Iridium* OJ [1997] L16/87, para. 42 and Case IV/34.768 - *International Private Satellite Partners* OJ [1997] L16/87, para. 55:

“In addition, as regards marketing and distribution, the principle of uniform prices and other conditions in different territories, together with the implementation of such marketing in a decentralized manner, seems appropriate to fulfil the needs for world-wide telecommunications services, on a one-stop-shopping and billing basis, of customers having branches or subsidiaries dispersed in different territories.”

<sup>30</sup> The Consultation Paper concedes that neither individual airlines nor airline alliances are in a position to fulfil all consumer demand for the joint product offered by airlines who participate in IATA Tariff Conferences: see Consultation Paper, Annex 2, point ix.

- Participation in IATA Tariff Conferences does not in any way restrict the participating airlines in their freedom to take independent commercial decisions as to the pricing of on-line or carrier-specific tickets.<sup>31</sup>
- IATA tariff consultation is aimed at producing a joint product – the multilateral interlinable ticket – not at fixing the price of their own products that they otherwise sell in competition with each other.
- IATA Tariff Conferences have a legitimate objective, which is not in itself anti-competitive – facilitating interlining.<sup>32</sup>
- IATA tariff consultation fulfils consumer demand which would otherwise remain unmet and thus increases output.

On this basis, IATA tariff consultation cannot be said to “decrease output and raise prices, leading to a misallocation of resources, because goods and services are not produced”<sup>33</sup> nor lead to a “reduction in consumer welfare, because consumers have to pay higher prices for the goods and services in question.”<sup>34</sup>

### 3. Do IATA Tariff Conferences have the effect of restricting competition for purposes of Article 81(1)?

The Consultation Paper theory for asserting that the IATA Tariff Conferences have the “effect” of restricting competition rests on two elements:

- coordination in the pricing of interline tickets necessarily affects and thus restricts competition in the pricing of on-line tickets; and
- these restrictive effects are reinforced by information exchange between airlines in the context of IATA Tariff Conferences.

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<sup>31</sup> It is evident that participation in IATA Tariff Conferences does not in any way restrict the participating airlines’ in their freedom to take independent commercial decisions as to the pricing of interline tickets as interline tickets could not be offered without price coordination. In this regard, the IATA Tariff Conference system can be distinguished from the “Reims II” agreement between European postal operators that sets terminal dues in respect of international mail. In its review of the Reims II agreement, the Commission found that the postal operators had, by entering into the agreement, eliminated or reduced their freedom to determine the level of remuneration for the delivery of inward cross-border mail. The Commission therefore came to the implicit conclusion that delivery of inward cross-border mail could take place in the absence of price coordination between postal operators. Case No. COMP/38.170 – *Reims II*, OJ [2004] L56/76.

<sup>32</sup> See also Opinion of Advocate General Tesouro in Case C250/92 *Gottrup-Klim, Grovvefareforeninger v. Dansk Landbrugs Grovvarselkab AmbA* [1994] ECR I-5641; Case C306/96 *Javico International and Javico AG v. Yves Saint Laurent Parfums SA* [1998] ECR I-1983; Case 161/84 *Pronuptia de Paris GmbH v. Irmgard Schillgallis* [1986] ECR 353; Case C-110 &241-242/88 *Lucazeau v. SACEM* [1989] ECR 2811.

<sup>33</sup> Article 81(3) Guidelines, para. 21.

<sup>34</sup> Article 81(3) Guidelines, para. 21.

The existence of these supposed restrictive effects is asserted without any discussion of the market context in which the IATA Tariff Conference system operates and without reference to any economic analysis. This analysis is simply inadequate to provide the basis for applying Article 81.

The modern approach to Article 81 analyses restrictive effects on a strictly economic basis. For an agreement to have the “effect” of restricting competition for purposes of Article 81(1) it must affect actual or potential competition to such an extent that on the relevant market negative effects on prices, output, innovation or the variety or quality of goods and services can be expected with a reasonable degree of probability.<sup>35</sup> Such negative effects must be *appreciable* – the prohibition rule of Article 81(1) does not apply when the identified anti-competitive effects are *insignificant*.<sup>36</sup> Thus the prohibition rule of Article 81(1) only applies where on the basis of proper market analysis it can be concluded that the agreement has likely appreciable anti-competitive effects on the market.<sup>37</sup> The burden of proof for showing that such effects exist normally rests with the Commission.<sup>38</sup>

It is important to note that it is not sufficient to show that an agreement or practice has “affected” competition to invoke Article 81(1). The assertion in the Consultation Paper that “airlines have no choice but to give appropriate consideration to the level of IATA fares”, even if it were true, does not by itself show a *restrictive* effect on competition. The key question that determines whether the IATA tariff conferences have the effect of restricting competition is whether they have the effect of increasing prices or reducing output in airline markets.

Ultimately the question of restrictive effects is an empirical question, where the Commission should have the burden of showing significant effects in terms of higher prices, limited capacity or reduced consumer choice. IATA has nonetheless commissioned CRA to consider whether, from an economic perspective, the operation of the IATA tariff conference system can be regarded as having a restrictive effect on competition. The CRA paper shows that the “price coherence” theory does not provide a theoretically sound basis for assuming that agreement of prices for multilateral interline travel will lead to an anticompetitive effect on prices. The CRA paper also shows that the information exchanged within the IATA conference is of a type that is unlikely to facilitate collusion between IATA airlines on their airline-specific fares. Overall the CRA report suggests that the structure of the industry and the nature of airline-specific fares makes collusion unlikely.

CRA’s analysis of the information exchange issue is in line with the substantial body of precedent on information exchange under Article 81. These precedents make clear that information exchange between competitors needs to be assessed in its economic context. It is apparent both from the case-law and the Commission’s practice that information exchange agreements are not generally prohibited automatically but only if they have certain

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<sup>35</sup> Article 81(3) Guidelines, para. 24.

<sup>36</sup> Article 81(3) Guidelines, para. 24.

<sup>37</sup> This approach takes into account the economic approach on which the Guidelines are based and “gives Article 81(1) a fairly narrow scope of application”. See Gauer, Kjølbye et al., op cit.

<sup>38</sup> Article 2, Council Regulation (EC) No 1/2003 on the implementation of the rules of competition laid down in Articles 81 and 82 of the Treaty, OJ [2003] L1/1. See Jürgen Schwarze & Andreas Weitbrecht, Grundzüge des europäischen Kartellverfahrensrechts, § 11, 29 et seq.

characteristics relating, in particular, to the sensitive and accurate nature of recent data exchanged at short intervals.<sup>39</sup> It is recognized in this regard that the more concentrated the markets, the more likely it will be that competition is being restricted by information exchanges between competitors.<sup>40</sup> This will be even more so if the products in the concentrated market are homogeneous.<sup>41</sup> A further important factor in the assessment of the market structure is the existence of barriers to entry.<sup>42</sup>

The factors cited in the cases are consistent with the analysis of the actual practice in IATA conferences as set out in the CRA Paper in Annex IV and the IATA description in Annex V. The safeguards that are in place ensure that no sensitive information is exchanged. The information that is exchanged is limited to that needed to allow the conference to function, facilitating the creation of the multilateral interline product.<sup>43</sup> Consequently, information exchange may be regarded as objectively necessary for, and proportionate to, the creation of the interline ticket.<sup>44</sup> Furthermore, the very transparent nature of airline pricing means that any information disclosed in IATA Tariff Conferences is unlikely to have an appreciable effect on pricing.<sup>45</sup>

From a legal perspective, the failure to show appreciable restrictive effects (or indeed any restrictive effects at all) is particularly important. It means that application of Article 81 rests on a formalistic finding of a “restriction by object” in a context where it is hard to maintain that restrictive effects are highly likely or inevitable. Even more important, the nature and extent of restrictive effects are vital in assessing the requirements of Article 81(3). As explained below, the lack of significant quantifiable restrictive effects means that there is no reasonable basis for contending that (i) the IATA conference system does not provide net benefits (as long as there is some demonstrable benefit); (ii) any restrictive effects are not “indispensable”; or (iii) the system “eliminates” competition.

#### 4. The IATA Conference System Meets All the Requirements of Article 81(3) EC

Article 81(3) of the Treaty only becomes relevant when an agreement between undertakings restricts competition within the meaning of Article 81(1). In the case of non-restrictive agreements there is normally no need to examine any benefits generated by the agreement.<sup>46</sup>

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<sup>39</sup> Case T-16/98 *Wirtschaftsvereinigung Stahl* [2001] ECR II-1217, para. 44.

<sup>40</sup> See e.g. *UK Agricultural Tractor Registration Exchange*, OJ 1992 L 68/19, paras. 35 et seq.; *Wirtschaftsvereinigung Stahl* OJ 1998 L 1/10, paras. 39 et seq. Another factor in the analysis is the combined market share of the parties to the agreement. The CFI has not objected to this approach, cf. Case T-34/92 *Fiatagri and New Holland Ford* [1994] ECR II-905, para. 91; Case T-16/98 *Wirtschaftsvereinigung Stahl* [2001] ECR II-1217, para. 38.

<sup>41</sup> See e.g. T-141/94 *Thyssen Stahl* [1999] ECR II-347, para. 399; T-136/94 *Eurofer* [1999] ECR II-263 para. 64.

<sup>42</sup> See Commission and CFI in *Wirtschaftsvereinigung Stahl*, *ibid.* Imports from outside the EU can also play a role, cf. *UK Agricultural Tractor Registration Exchange*, OJ 1992 L 68/19, para. 35.

<sup>43</sup> See e.g. Consultation Paper, para. 67 and Consultation Paper Annex 2, point ix.

<sup>44</sup> Article 81(3) Guidelines, para. 31.

<sup>45</sup> Using e.g. a computerized reservation system, the process of gathering such information is very quick (almost real-time) and simple. Contrast *Cobelpa/VNP*, OJ [1977] L1242/10, at para. 30.

<sup>46</sup> Article 81(3) Guidelines, para. 40.



For the reasons set out in the previous sections, IATA does not regard the conference system in its modern form as restrictive of competition. In order to ensure full legal certainty for the industry, however, particularly in light of the concern of some competition enforcement authorities regarding the IATA conference system, the application of Article 81(3) to the IATA conference system should be addressed.

*General principles applicable to Article 81(3) analysis.* Article 81(3) explicitly applies to an “agreement or category of agreements between undertakings”; a “decision or category of decisions by associations of undertakings” or to a “concerted practice or category of concerted practices”. Article 81(3) cannot therefore be applied to an individual restriction isolated from its context – an enforcement authority or court applying Article 81(3) must consider the restrictive effects and economic benefits of the agreement or practice as a whole, in the form presented by the parties.

Article 81(3) does not exclude *a priori* certain types of agreements from its scope. As a matter of principle all restrictive agreements that fulfil the four conditions of Article 81(3) are covered by the exception rule.<sup>47</sup> Indeed Article 81(3) on its face expressly acknowledges that restrictive agreements may generate objective economic benefits so as to outweigh the negative effects of the restriction of competition.<sup>48</sup> When the pro-competitive effects of an agreement outweigh its anti-competitive effects, the agreement is on balance pro-competitive and compatible with the objectives of the Community competition rules. The *net effect* of such agreements is to promote the very essence of the competitive process, namely to win customers by offering better products or better prices than those offered by rivals.<sup>49</sup>

The application of Article 81(3) is subject to four cumulative conditions, two positive and two negative:

- (a) the agreement must contribute to improving the production or distribution of goods or contribute to promoting technical or economic progress;
- (b) consumers must receive a fair share of the resulting benefits;
- (c) the restrictions must be indispensable to the attainment of these objectives; and finally
- (d) the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.

The application of each of these requirements to IATA Tariff Conferences is discussed in turn below.

*IATA Tariff Conferences Promote “Economic Progress.”* For an agreement, decision or practice to qualify for Article 81(3) exemption, its *net effect* must be beneficial, *i.e.*, the benefits of the agreement as a whole must be shown to outweigh the restrictive effects

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<sup>47</sup> Case T-17/93, *Matra* [1994] ECR II-595, para. 85. See also Richard Whish, “Competition Law”, LexisNexis Butterworths, Fifth Edition, at p. 150 with further examples.

<sup>48</sup> Article 81(3) Guidelines, para. 33.

<sup>49</sup> Article 81(3) Guidelines, para. 33.

identified in an Article 81(1) analysis.<sup>50</sup> This analysis requires a quantitative economic assessment of the agreement, decision or practice in order to carry out the balancing of restrictive effects against benefits.<sup>51</sup>

It follows that where the results of this assessment find no empirical evidence of restrictive effects, *any* appreciable benefit that results from the agreement, decision or practice will fulfil the requirements of Article 81(3). Furthermore, it follows that where appreciable net benefits can be shown, it is irrelevant whether such benefits “range from low to moderate”,<sup>52</sup> *i.e.*, the significance of the agreement, decision or practice in the context of the markets affected is not relevant to the application of the first condition of Article 81(3).<sup>53</sup> In particular, there is no basis under Article 81(3) to dismiss the relevance of a benefit because it only arises in a relatively limited percentage of transactions in a broader market. Thus the attention paid by the Commission services in the context of this consultation and prior consultations to the *percentage* of journeys or shipments by air that involve interlining<sup>54</sup> is entirely irrelevant to the application of Article 81(3). The only relevant criterion is the quantifiable extent of the benefit in absolute terms.

It is undisputed that IATA Tariff Conferences produce efficiencies that are objective in nature.<sup>55</sup> It is also undisputed that there is a sufficient and direct causal link between the agreement and its identified benefits.<sup>56</sup> Furthermore, as set out in the main text and in the CRA paper in Annex III, IATA Tariff Conferences produce both cost and qualitative

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<sup>50</sup> Article 81(3) Guidelines, para. 33. *See* Joined Cases 56/64 and 58/66, *Consten and Grundig* [1966] ECR 429: “[...] This improvement must in particular show appreciable objective advantages of such a character as to compensate for the disadvantages which they cause in the field of competition.” *See* in addition Joined Cases 209-215/78 and 218/78 *Van Landewyck v. Commission* [1980] ECR 3125; Joined Cases 25 and 26/84 *Ford v. Commission* ECR [1985] 2725; Case 75/84 *Metro II* [1986] ECR 3021; *Vichy* OJ [1991] L75/57; *Schoeller* OJ [1993] L183/1; *SCK/FNK* OJ [1995] L312/79. *See* also *e.g.* Jonathan Faull & Ali Nikpay, “The EC Law of Competition”, Oxford University Press, at para. 2.121. It will be noted that the Article 81(3) Guidelines take a somewhat different approach, assigning the balance of restrictive effects and benefits to the “fare share for consumers” requirement of Article 81(3) (see Article 81(3) Guidelines, at paras. 85-86.) The Consultation Paper asserts that the balance forms part of the indispensability assessment (Consultation Paper at point 65). These approaches, however, are plainly contradicted by the cases and decisions cited above.

<sup>51</sup> Article 81(3) Guidelines, paras. 55 and 101. *See* also Case T-206/99 *Métropole Télévision SA v. Commission*, Judgment of 20 March 2001, at para. 57:

“[...] according to consistent case-law, where the Commission has a power of appraisal in order to carry out its duties, respect for the rights guaranteed by the Community legal order in administrative procedures is all the more fundamental. Those guarantees include, in particular, the duty of the competent institution to examine carefully and impartially all the relevant aspects of the individual case (Case C-269/90 *Technische Universität München* [1991] ECR I-5469, paragraph 14; Case T-44/90 *La Cinq v. Commission* [1992] ECR II-1, paragraph 86).”

<sup>52</sup> Consultation Paper, para. 58.

<sup>53</sup> *See* also Article 81(3) Guidelines, para. 85: “[...] In line with the overall objective of Article 81 to prevent anti-competitive agreements, the net effect of the agreement must be at least neutral from the point of view of those consumers directly or likely affected by the agreement.”

<sup>54</sup> *See e.g.* the second and fourth questions set out at point 63 in the Consultation Paper.

<sup>55</sup> Consultation Paper, para. 48, second bullet point and para. 50. As to the objective nature of benefits, *see* also Article 81(3) Guidelines, para. 49.

<sup>56</sup> For example, *see* Consultation Paper, para. 56: “[...] it appears that the said “itinerary flexibility” may be considered a consumer benefit, which is specific to the IATA Interlining System.” *See* also Article 81(3) Guidelines, para. 53.

efficiencies by allowing a new service to be introduced on the market more quickly and at lower cost.<sup>57</sup> Moreover, it is clear that the concrete benefits of the IATA Tariff Conference are sufficiently valuable to cause thousands of passengers with a wide choice of airlines and ticketing options to have purchased interline tickets in the past and to continue to purchase them in the future.<sup>58</sup> It is also clear that the IATA Tariff Conferences continue to be important for certain categories of cargo shipments between the EEA and third countries.

*Consumers Receive a Fair Share of the Resulting Benefit.*<sup>59</sup> The availability of new and improved products constitutes an important source of consumer welfare. As long as the increase in value stemming from such improvements exceeds any harm from a maintenance or an increase in price caused by the restrictive agreement, consumers are better off than without the agreement and the consumer pass-on requirement of Article 81(3) is normally fulfilled.<sup>60</sup> Similarly, where it is shown that consumers will benefit from more favourable prices as a result of the agreement, decision or practice, the second condition is also likely to be fulfilled.<sup>61</sup> In addition, the “consumer benefit” condition is likely to be fulfilled where the underlying markets are competitive as the benefits of the agreement, decision or practice will be passed on to the consumer as the various undertakings compete for business.<sup>62</sup>

Given that (i) the Commission has not demonstrated any maintenance or increase in price caused by the IATA Tariff Conference; (ii) the IATA interline ticket constitutes a joint product that increases choice and lowers prices; and (iii) air transport markets are generally competitive, it is clear that the second condition of Article 81(3) is fulfilled in the present case.

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<sup>57</sup> See Article 81(3) Guidelines, para. 71.

<sup>58</sup> See also the discussion in the CRA Paper in Annex III. In verifying the magnitude of a benefit under Article 81(3), there is no requirement (as the Commission appears to imply at para. 61 of the Consultation Paper) that a consumer actually “use” a particular feature of a product or service in order for a consumer to derive benefit from that product or service for purposes of Article 81(3). For example, applying the Commission’s apparent logic to the case of insurance products would mean that the benefits of an insurance product would only exist to the extent they were actually “used” (*i.e.*, the consumer made a claim against a policy). No value would be ascribed to the consumer’s “peace of mind” in being insured (which is valuable even if he/she may not be engaged in any particularly risky activity). Similarly, where a consumer bought *e.g.*, a mobile phone (or, in principle, any product) but did not use all its features, there could also be a doubt under Article 81(3) over whether consumers derive benefit from these unused features. As the Commission itself points out in the Article 81(3) Guidelines at para. 49, only *objective* benefits can be taken into account. The only objective standard that can be used in this context is that of the market, *i.e.*, if consumers find that the features of a product are valuable even though they may not actually use them, this should be a benefit of sufficient magnitude for purposes of Article 81(3).

<sup>59</sup> The discussion of this requirement in the Consultation Paper (at points 52-61) is somewhat confused because it focuses on the existence of the benefits (logically the first requirement) rather than on whether consumers share these benefits. The discussion in the text of this paper focuses on the more limited question of whether the benefits (identified in the previous section and discussed in the CRA paper in Annex III) are “shared” with consumers for purposes of Article 81(3).

<sup>60</sup> Article 81(3) Guidelines, para. 104.

<sup>61</sup> See *e.g.* *BT/MCI* OJ [1994] L223/36, rec. 55.

<sup>62</sup> See *e.g.* Horizontal Guidelines, para. 34.

*IATA Tariff Conferences are Necessary to Achieve the Full Benefits of the Multilateral Interlining System.*<sup>63</sup> According to the third condition of Article 81(3) an agreement must not impose restrictions, which are not indispensable to the attainment of the economic benefits created by the agreement in question (*i.e.*, the benefits identified in response to the first condition). In the context of this condition, the decisive factor is whether economic benefits are produced as a result of the agreement that would not be fully realized in the absence of the agreement.<sup>64</sup>

This condition requires that the efficiencies be specific to the agreement in question in the sense that there are no other economically practicable and less restrictive means for the parties to achieve these efficiencies.<sup>65</sup> In making this assessment the market conditions and business realities facing the parties to the agreement must be taken into account. Firms invoking the benefit of Article 81(3) are not required to consider hypothetical or theoretical alternatives. The Commission recognizes in its Guidelines that it cannot second guess the business judgment of the parties. Intervention is only appropriate where it is reasonably clear that there are realistic and attainable alternatives. The parties must only explain and demonstrate why such seemingly realistic and significantly less restrictive alternatives to the agreement would be significantly less efficient.<sup>66</sup>

It follows that there is thus no scope under the third condition of Article 81(3) for an assessment of whether theoretical alternative arrangements that would result in lesser benefits would be somehow “preferable”. Indeed, the wording of Article 81(3) itself<sup>67</sup> makes it clear that it is not sufficient that such an alternative arrangement reproduce the “bulk of existing benefit”<sup>68</sup> – any alternative must reproduce the *entire benefit* of the existing system.<sup>69</sup> There is also no scope for an assessment of whether *other parties* might create alternative arrangements that could duplicate or improve upon the benefits of the agreements, decisions

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<sup>63</sup> As already noted, the analysis of this requirement in the Consultation Paper (at paras. 64-65) is somewhat confused, since it posits a balance between benefits and restrictive effects properly performed in the context of the first Article 81(3) requirement.

<sup>64</sup> Article 81(3) Guidelines, para. 74.

<sup>65</sup> Article 81(3) Guidelines, para. 75. See also *FN/CF* OJ [1971] L134/6; *GEC/Weir Sodium Circulators* OJ [1977] L327/26; *Amersham/Buchler* OJ [1982] L314/34; *Ivoclar* OJ [1985] L369/1; *X/Open Group* OJ [1987] L35/36; *ABI* OJ [1987] L43/51; *Iveco/Ford* OJ [1988] L230/39; *BBC Brown Boveri* OJ [1988] L301/68; *Delta Chemie/DDD* OJ [1988] L309/34; *Alcatel/Espace/ANT* OJ [1990] L32/19; *Concordato Incendio* OJ [1990] L15/25; *Grundig II* OJ [1994] L20/15; *Jahrhundertvertrag*; OJ [1993] L50/14; *Fujitsu/AMD* OJ [1994] L341/66; *Asahi/St. Gobain* OJ [1994] L354/87; *Atlas* OJ [1996] L239/23; *Phoenix/GlobalOne* OJ [1996] L239/57.

<sup>66</sup> Article 81(3) Guidelines, para. 75.

<sup>67</sup> Article 81(3) refers to “resulting benefit” (2<sup>nd</sup> condition) and “these objectives” (3<sup>rd</sup> condition). It clearly does not refer to “the bulk” of the resulting benefit or “the bulk” of these objectives.

<sup>68</sup> The analysis in the Consultation Paper (at para. 66) is simply wrong as a matter of law.

<sup>69</sup> See Case 27/76 *Metro I* [1977] ECR 1875; *SOPELEM/Vickers* OJ [1978] L70/47; *Rockwell/Iveco* OJ [1983] L224/19; *VW/MAN* OJ [1983] L376/11; *Optical Fibres* OJ [1986] L236/30; *ENI/Montedison* OJ [1986] L5/13; *Enichem/ICI* OJ [1988] L50/18; *IATA Passenger Agency Programme* [1991] L258/18; *IATA Cargo Agency Programme* [1991] L258/29; *Assurpol* OJ [1992] L37/16; *Ford/Volkswagen* OJ [1993] L20/14; *Pasteur/Mérieux* OJ [1994] L30/1; *Philips/Osram* OJ [1994] L378/37; *Lufthansa/SAS* OJ [1996] L54/28; *Scottish and Newcastle*, OJ [1999] L186/28, para. 162; *Whitbread*, OJ [1999] L88/26, para. 175; *Bass* OJ [1999] L186/1, para. 193. See also Jonathan Faull & Ali Nikpay, *op cit.*, at para. 2.166; Sauter in Immenga/Mestmäcker, *EG-Wettbewerbsrecht*, Art. 85 EGV, 25.

or practices in question – Article 81(3) clearly refers only to the parties to the agreement, decision or practice that is under investigation.

Once it has been established that the agreement, decision or practice results in an appreciable net benefit under the first condition of Article 81(3), there can be no additional requirement to show proportionality between benefits and restrictive effects imposed under the third condition of Article 81(3). The Community law principle of proportionality has not been developed to determine whether a particular agreement, decision or practice promotes the competitive process, namely to win customers by offering better products or better prices than those offered by rivals. This role fulfilled by the balancing process under the first condition of Article 81(3).

The posted prices system which the Consultation Paper puts forward as an alternative does not meet the requirements for disproving the indispensability of IATA Tariff Conferences. First, there is no likelihood that the airlines would erect such a system if the IATA conference system is outlawed.<sup>70</sup> Second, the Consultation Paper admits that a posted price system does not “reproduce the entire benefits” of the existing IATA system.<sup>71</sup> Furthermore, it is evident not only that a system of posted prices could not reproduce the entire benefits of the IATA system but also that *there is no alternative economically practicable system that could do so*.<sup>72</sup> Consequently, there can be no doubt that economic benefits are produced with the agreements in the context of the IATA Tariff Conferences that could not be duplicated by IATA or its members in the absence of the agreement.

*IATA Tariff Conferences Do Not “Eliminate” Competition.* The fourth condition of Article 81(3) bars application of Article 81(3) where an agreement leads to the *elimination* of competition in a substantial part of the EU. This provision is intended to ensure that the degree of competition necessary to ensure the observance of the basic requirements and the attainment of the objectives of the Treaty is preserved.<sup>73</sup> Whether competition is being “eliminated” within the meaning of the fourth condition of Article 81(3) will depend on the degree of competition existing prior to the agreement and on the impact of the restrictive

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<sup>70</sup> The fact that no posted-price system emerged in the United States after the removal of the regulatory-based multilateral interline system in the 1970s is indicative of the fact that there is no assurance that such a system would evolve in the EU.

<sup>71</sup> Consultation Paper, para. 67 and Consultation Paper Annex 2, point ix.

<sup>72</sup> See also the UK Office of Fair Trading Competition Act 1998 Guideline 439, “Public transport ticketing schemes block exemption”, at para. 3.18:

“[...] Because of the flexibility of passenger use of MTCs [multi-operator travel cards valid on local public transport services which entitle ticket holders to make multiple journeys on a number of different operators’ services across a number of different routes] and the consequence that operators will not know what journeys have been made using each ticket, it is clearly not possible to use a “posted price” mechanism for revenue reimbursement in the same way as for other ticket types [...]. The operators could conceivably each agree to participate in an MTC in exchange for a fixed fee which could then form the basis of the price at which each operator decided to sell the MTC in the light of that commitment. That would be cumbersome, at the least, however, and would impose some risk on operators. It would also mean that the revenue received from the scheme would bear no resemblance to usage of the services of each operator. It seems, therefore, that the only satisfactory solution is for a common agreed price for an MTC.”

<sup>73</sup> See, e.g., Case 26/76 *Metro v. Commission* [1977] ECR 1875; Case T-7/93 *Langnese-Iglo v. Commission* [1995] ECR II-1533.

agreement on competition, *i.e.*, the reduction in competition that the agreement brings about.<sup>74</sup>

It is evident that the standard required to show that competition is “eliminated” is higher than that required to show that competition is “restricted”.<sup>75</sup> The Court of Justice has suggested that this point may be reached where competition is no longer “effective” in a significant market as a result of the agreement,<sup>76</sup> *i.e.*, that as a result of the agreement the parties to the agreement are no longer under effective competitive constraint from each other or from third parties.

The Consultation Paper asserts that IATA Tariff Conferences could eliminate competition within the meaning of Article 81(3) on routes between the hubs of competing alliances.<sup>77</sup> If correct, this means that British Airways does not impose an effective competitive constraint on Lufthansa on the route from London to Frankfurt, or that KLM/Air France does not impose a competitive constraint on SAS for services from Amsterdam to Copenhagen.<sup>78</sup> Indeed, as IATA Tariff Conferences have set fares in respect to these routes since the inauguration of air transport liberalization, this analysis would suggest that these routes have *never* been subject to effective competition. This conclusion is, of course, absurd. There is simply no basis for asserting that IATA tariff consultation eliminates competition within the meaning of Article 81(3).

## 5. Current Industry Interlining Practice is Consistent with Regulation 1617/93

The Consultation Paper identifies two issues regarding the application of Regulation 1617/93 to multilateral interlining as currently practiced. The first issue involves the compatibility of current practice with the definition of “interlining” set out at Article 4(1)(b) of the Regulation. The second issue involves the requirement in Article 4(1)(e) of the Regulation that fares discussed in IATA conferences not be “binding”. For the reasons set out below, the concerns set out in the Consultation Paper in regard to these two issues are misplaced.

***The Definition of “Interlining” and Current Practice.*** Article 4(1)(b) of Regulation 1617/93 provides that the exemption for airline tariff consultations only applies if

“(b) the consultations give rise to interlining, that is to say, air transport users must be able, in respect of the types of fares or rates and of the seasons which were the subject of the consultations:

(i) to combine on a single transportation document the service which was the subject of the consultations, with services on the same or on connecting routes operated by

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<sup>74</sup> Article 81(3) Guidelines, para. 107; Schröter, *op. cit.*, at 330.

<sup>75</sup> Otherwise Article 81(3) would be redundant since it only becomes applicable where there is a restriction of competition.

<sup>76</sup> *See Case 26/76 Metro v. Commission* [1977] ECR 1875.

<sup>77</sup> Consultation Paper, para. 70.

<sup>78</sup> The conclusion with respect to London-Frankfurt is directly contradictory to the Commission analysis in *British Midland, Lufthansa, SAS* [1991] OJ C 83/6, which allowed British Midland and Lufthansa to link their services on the London-Frankfurt route.

other air carriers, whereby the applicable fares, rates and conditions are set by the airline(s) effecting carriage; and

(ii) in so far as is permitted by the conditions governing the initial reservation, to change a reservation on a service which was the subject of the consultations onto a service on the same route operated by another air carrier at the fares, rates and conditions applied by that other carrier [...].”

According to the Consultation Paper<sup>79</sup>, the industry practice is inconsistent with this definition, in particular the ability of customers under the current system to choose between a range of connecting points and change to a different routing using a different connecting point.

It appears<sup>80</sup> that the Consultation Paper starts from the premise that Article 4(1)(b)(i) *requires* that an airline issuing an interlinable ticket issue the first “segment” on its service (on a non-interlinable basis) and then designates a second airline’s service for the second segment (on an interlinable basis). This analysis is flawed for two reasons. First, it appears to depend on identifying the word “service” in Article 4(1)(b) with a “flight sector” or “segment”— a non-stop city-pair service.<sup>81</sup> In fact, it has been understood since this definition was first developed in 1993 that a “route” for this purpose includes a “city pair” operated using connecting services and a “service” includes a non-stop service on a route, a connecting service on a route, as well as a service on one or more sectors forming part of a route. Second, the Consultation Paper analysis appears to assume that any ticket issued on an interline basis must meet the requirements of both Article 4(1)(b)(i) and Article 4(1)(b)(ii) where the text makes clear that it is the *tariff* set in the consultations that must be usable for both purposes.

The proper reading of the Regulation may be explained by reference to the example provided in the Consultation Paper – a booking from Prague to Strasbourg *via* Paris. The Consultation Paper asserts that Article 4(1)(b)(i) would apply to a booking on CSA from Prague to Paris, issued on the same document as a further booking on Air France from Paris to Strasbourg. According to the Consultation Paper, the CSA sector should not be interlinable, since the Air France sector Paris-Strasbourg is the “service” for purposes of Article 4(1)(b)(i). In fact, the “service” could also be the city-pair Prague-Strasbourg, in which case the applicable IATA tariff would be the Prague-Strasbourg through fare. In effect, CSA has issued this ticket by combining its “service” on the route subject to the consultations, with that of another airline. If the customer opts to change to a different routing (*e.g.*, *via* Amsterdam, as suggested in the Consultation Paper) the customer is using the flexibility provided by Article 4(1)(b)(ii) by changing from one Prague-Strasbourg “service” to another.<sup>82</sup>

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<sup>79</sup> Consultation Paper, points 14-17.

<sup>80</sup> Consultation Paper, at n. 12.

<sup>81</sup> This is evident from the paraphrase of the relevant language of Article 4(1)(b)(i) in the Consultation Paper at pt. 14: “passengers must have the ability to combine on a single ticket one or more “segments” “which [were] the subject of the consultations”.

<sup>82</sup> It will be noted that this reading of Article 4(1)(b) also allows the use of an IATA fare on one city-pair to be used together with a fare on a second city-pair to “construct” a fare. (This is the relevance of the phrase “on connecting routes” in Article 4(1)(b)(i)).

The fact that the conditions apply to the tariff and not to a particular ticket is clear if the Prague-Strasbourg example is slightly altered. CSA might issue a ticket on its own non-stop Prague-Strasbourg service with the original booking on CSA in both directions – Article 4(1)(b)(i) would not on its terms be applicable to this ticket. If the ticket is issued at a fare established in tariff consultations subject to Regulation 1617/93, however, the customer can switch to an Air France non-stop service or an Air France connecting service (or to a combined CSA-Air France connecting service or to any other alternative via other carriers and/or airports within the distances restrictions) because of the requirements of Article 4(1)(b)(ii). Thus, returning to the original example, the use by CSA of the IATA Prague-Strasbourg tariff created an *obligation* under Article 4(1)(b)(ii) to allow the customer to switch to another routing in order to reach Strasbourg.

In short, the language of Article 4(1)(b) was intended to ensure that fares discussed in tariff conferences should in fact be usable for interlining as actually practiced in the industry (which has not changed in this regard since 1993 and which the Commission staff at that time fully understood). In the discussions between the Commission staff and IATA representatives at that time, there was no suggestion that the Commission intended that industry practice needed to change. Furthermore, a careful reading of Article 4(1)(b) shows that the actual language does not require such a result. The concerns expressed in the Consultation Paper on this point are misplaced.

***Are fares discussed in IATA conferences “binding”?*** Article 4(1)(e) of Regulation 1617/93 requires that:

“[T]he consultations are not binding on participants, that is to say, following the consultations the participants retain the right to act independently in respect of passenger and cargo tariffs [...]”

The Consultation Paper recognizes that airlines retain a “theoretical right to act independently” but suggests that “the way that the IATA interlining system is structured may impose some form of *de facto* economic obligation [...] to issue IATA interlinable tickets at the actual rates agreed in the conferences.”<sup>83</sup> The Consultation Paper goes on to suggest that it may be necessary to discuss “whether this practice conforms with the underlying rationale of Article 4(1)(e) and whether the latter ought to be modified in any way.” This comment reflects a lack of understanding of the specific requirements of Article 4(1)(e) and of the “rationale” for that provision.

As regards the “rationale” for Article 4(1)(e), the history of this provision is instructive. This provision is based on Article 4(1)(e) of Regulation 2671/88. The background for this provision in Regulation 2671/88 was that, prior to 1987, tariffs agreed at IATA Tariff Conferences *were* binding for intra-Community travel – airlines were obliged to file the tariffs agreed in the conference with their respective aviation regulatory authorities and could not file carrier-specific tariffs. As part of the process leading to the first block exemption package, the industry, Member States, and the Commission agreed that the binding nature of tariffs established in conferences for traffic within the EU would be dropped. This was reflected in the original language of Article 4(1)(e):

“[A]ny draft tariff proposals which may result from the consultations are not binding on participants, that is to say, following the consultations the participants retain the right to act

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<sup>83</sup> Consultation Paper at point 17.



independently both in putting forward proposals independently of the other participants and in freely applying such tariffs after they have been approved.”<sup>84</sup>

It is evident from this language that the focus of Article 4(1)(e) was on possible limitation on the ability of airlines to file and apply their own carrier-specific fares. When as a result of agreement on the Third Package in 1992, the language regarding “draft tariff proposals”, “putting forward” tariff proposals” and “applying tariffs” became redundant (because there was no longer provision for filing tariffs on intra-EU services) these phrases were removed in Regulation 1617/93. The rationale for the provision did not change, however. The purpose of the provision was to ensure that tariff consultations were not used to restrict the ability of airlines to set *their own* passenger and cargo tariffs.

This rationale is reflected in the 1993 language of Article 4(1)(e) and in current practice. In practice tariff consultations do not today restrict the ability of airlines to set their own tariffs, as the plethora of carrier-specific tariffs make clear. Nor do tariff consultations “bind” airlines in respect of the tariffs charged for interline services, as is evident from the many bilateral agreements in the market that allow multi-carrier travel at different rates. Airlines clearly retain and use “the right to act independently in respect of passenger and cargo tariffs”.

The analysis in the Consultation Paper also ignores a central point about the IATA multilateral interline system. The Paper refers to a *de facto* economic obligation [...] to issue IATA interlinable tickets at” the conference rate. The IATA system does not, however, create any obligation, *de jure* or *de facto*, on any airline to *issue* an IATA interlinable ticket. The obligation created by the IATA system and by Regulation 1617/93 only requires airlines that have participated in consultations to *accept a booking* that is made at an interlinable rate. The extent to which an airline chooses *to sell tickets* that have a multilateral interline capability is thus a matter of commercial choice that airlines make on a fully independent basis.<sup>85</sup>

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<sup>84</sup> This language in turn reflected the requirements of the original language of Regulation 3976/87, Article 2(2) which authorized a block exemption provided that “consultations on this matter are voluntary, that air carriers will not be bound by the results, and that the Commission and Member States [...] may participate as observers [...].”

<sup>85</sup> Similarly the fact that an airline might choose through a corporate discount program to give a post-facto discount on travel at an IATA fare that was actually flown on its services is neither governed by the IATA Tariff Conference system nor suggestive that there is somehow a lack of competition where such discounting does not occur. The rationale and existence of such discounts is a question of the commercial policy of each airline and if the airline decides in effect to treat the IATA fare as a carrier-specific fare when travel takes place on its services does not mean that in all other cases where discounts are not given the airline is acting in contravention of Regulation 1617/93 or otherwise producing a restrictive effect within the terms of Article 81 EC as note above.



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**ANNEX II**

**COMMENTS OF IATA ON**

**DG COMPETITION CONSULTATION PAPER CONCERNING  
REGULATION 1617/93**

**SOME FACTS ABOUT THE ECONOMIC GEOGRAPHY OF AIR  
TRANSPORT IN THE EUROPEAN ECONOMIC AREA**



## **SOME FACTS ABOUT THE ECONOMIC GEOGRAPHY OF AIR TRANSPORT IN THE EUROPEAN ECONOMIC AREA**

### **1. INTRODUCTION**

The Consultation Paper issued by DG Competition on 30 June 2004 concerning Commission Regulation 1617/93 is based on certain assumptions about the air transport market in the European Economic Area (EEA) that are not borne out by the facts.

The purpose of this Annex to the "IATA Response" is to present some basic facts regarding airport infrastructure in the EEA and the European and non-European airlines serving these airports.

A weakness of the European Commission's (CEC) Consultation Paper is that it reflects a simplistic view of the complex realities of commercial air services in the European Union and the associated EEA states.

The Consultation Paper focuses on alliance member airlines and major airports, erroneously describing them as 'hub airports' on account of their size, to the detriment of non-alliance carriers, smaller airlines, and airlines and airports in the new Member countries.

Some basic facts may help to refocus thinking on the benefits of multilateral interlining so that decisions are based on a fuller understanding of the big picture. Network services by their nature are complex and permit traffic to flow over different nodes. Flexibility is a key attribute of a network, ensuring alternative routings and the ability to provide service to the smallest communities. A European airline network that embraces different levels of links from the multilateral to privileged alliance links has economic, social and security benefits that should not be underestimated nor hastily abandoned.

This data shows that the underlying geography of air transport in the EEA is complex and that withdrawing the exemption for the IATA multilateral interline fare consultations in the EEA would have a much wider impact on communities and airlines throughout the region.

The principal sources of data for this analysis are the Official Airline Guide data tapes for July 2004, the IATA "Multilateral Interline Traffic Agreements Manual (MITA)" (70<sup>th</sup> Edition, effective 1 April – 31 July 2004) and the IATA "City Code Directory" (42<sup>nd</sup> Edition, effective 1 April 2004).

### **2. AIRPORT INFRASTRUCTURE**

The only reference in the Consultation Paper to airports is the definition of *hubs* as "airports, which are in the top 25 European airports in terms of passengers" (page 23, footnote 37).

In making this statement, the Commission asserts (a) that size alone is a criteria for assessing whether an airport should be classified as a 'hub', and (b) that in the context of assessing the value of multilateral and alliance interlining, only these airports merit close consideration.

The following analysis shows that this is a simplified appraisal of the EEA's airport infrastructure and of the needs of the communities they serve.

## 2.1 Number of Airports

The distribution of airports in the EEA is very uneven from country to country reflecting the varied geography of the 29 states of the EEA and of surface transport networks (in this paper we have treated Switzerland as part of the EEA). Some countries are large and sparsely populated (Sweden, Norway); others have many island communities (Denmark, Greece, Spain and the United Kingdom).

In mid-2004, 640 airports were open to commercial traffic in the EEA (of which 543 in the EU). Table 1 shows the distribution of airports by country:

- Number of airports in EEA receiving scheduled service = 488 (Table 1)
  - Countries with the largest number of airports are France (60), UK (59), Norway (49), Sweden (43), Spain (40), Italy (40), and Germany (39).
  - The newest Member States of the EU generally have the smallest number of commercial airports.
- Elsewhere in the paper, reference is made to 437 cities receiving service. The difference between 437 and 488 is due to multi-airport cities (29 airports for 12 cities) and the remainder to seasonal service or less than weekly service.

***Communities in the 29 countries of the region have access to global networks through about 488 airports currently receiving scheduled service. The density of the airport infrastructure reflects the transport geography of Europe and the transport needs of peripheral regions and island communities.***

## 2.2 Relative Ranking of Airports by Traffic

In 2003, 42 EEA airports ranked among the 150 busiest airports in the world in terms of passengers. Data for the top 25 are given in Table 2.

- Passenger traffic at the top 25 airports exceeds 10 million passengers a year.
  - Combined passenger traffic for the top 25 airports = 593 million.
  - Charter traffic predominates at Palma and Malaga.
- The next 17 airports ranged in size between 6 and 10 million passengers.
  - Combined passenger traffic for the next 17 airports = 141 million.
- The principal cities of 14 countries (including Switzerland) rank among the top 25.
- Prague (ranked 40th) is the only airport in a new EU member State to figure in the list.

This analysis suggests that focusing on high volume traffic flows, as the Consultation Paper does in places, presents a simplified assessment of the air transport needs of the EEA. Regulation based on such an analysis could result in marginalization of the ten new States of the European Union and miss important consumer benefits of the existing IATA system.

***The top 25 airports (with more than 10 million passengers) are not all 'hub' airports (see paragraph 2.3). Half of the EEA capital cities and nine of the ten new Member States do not figure among the top 42 airports ranking among the world's 150 busiest airports.***

### **2.3 Transfer Traffic at Major Airports**

A 'transfer' passenger transfers between flights with distinct flight numbers. A 'transit' passenger continues his journey on a service with the same flight number. Few airports publish transfer passenger statistics that provide the only objective manner to determine whether an airport is a hub or not.

The relative importance of transfer traffic is an objective measure of the 'hub' role played by airport. Table 3 provides a summary of the available data.

- Transfer passengers account for over a third of passengers at the 8 airports that are Europe's major international hubs feeding intercontinental route networks:
  - Frankfurt, Copenhagen, Amsterdam, Paris CDG, London LHR, Zurich, Madrid and Vienna.
- Transfer traffic at 6 other airports account for 20 – 32% of airport traffic:
  - Munich, Athens, Bodoe, Ljubljana, Kirkenes, Oslo.
- Athens, Bodoe, Ljubljana, and Kirkenes clearly show that smaller airports in terms of traffic play an important role as local hubs in peripheral regions (northern Norway, the Adriatic, and the Greek islands).
- Conversely, some airports with heavy traffic (e.g. Palma, Malaga, Las Palmas, Tenerife, Alicante) are served by point-to-point charter operations and have no transfer traffic.
- Assessing seat availability on regional and inter-continental services (see Table 2) shows that 11 airports act as major international hubs in the sense of providing a platform linking EEA communities with inter-continental destinations. Airports where inter-continental capacity represents more than 20% of capacity are:
  - London LHR (51%), Frankfurt (46%), Paris (44%), Amsterdam (35%), Vienna (32%), London LGW (31%), Milan (30%), Zurich (29%), Munich (21%), Manchester (22%) and Paris ORY (22%).

***'Hub' airports in the EEA can only be determined on the basis of the relative importance of 'transfer' traffic. Airports predominantly served by charter and low-fare point-to-point carriers that rank among the region's busiest airports should not be considered be termed 'hub' airports.***

### **2.4 Number of European Airlines serving EEA Airports**

- Analysis of OAG data on flights between EEA airports (a proxy for flights by European operators) shows that 183 airports, or 42% of the 437 EEA airports were served by only 1 airline.
  - A further 55 airports were served by 2 airlines for a total of 238.
- Furthermore, 174 airports were not served by any alliance-member airline.
- 245 airports had 10 or fewer departures per day.

***42% of EEA 437 communities are served by only one airline and consumers using these airports are therefore dependent on the viability***

***of that airline and interline connections for access to European and world networks.***

### **3. AIRLINES SERVING EEA AIRPORTS**

The situation concerning air carriers serving the EEA is also more complex than appears at first glance, with scheduled service being provided by 330 airlines (169 EEA carriers and 161 non-EEA carriers).

#### **3.1 Airlines based in EEA States**

- There were some 169 air carriers in the EEA as of July 2004. This testifies to the existence of a broad and competitive market. The list includes full service carriers, regional operators, low-fare carriers and some predominantly charter carriers.
- Table 1 shows the number of airlines by country. Those with the largest number are:
  - UK (22 airlines), Italy (21), Germany (19), France (14) and Sweden (12).
- 66 EEA carriers participate in the MITA agreements under which they have agreed to accept interline tickets issued by other airlines. Table 4 gives the number of agreements for those that have more than 20.
  - 38 of the 66 EEA carriers had agreements with more than 100 other airlines worldwide.

***169 airlines are based in EEA-Member countries of which 66 have agreements to accept interline tickets. This testifies to a broad and competitive market.***

#### **3.2 EEA Alliance Member Airlines**

The three global alliances, oneWorld, Sky Team and Star Alliance, play an important but limited role in providing air services in the EEA. Table 5 shows the core members of the three alliances that are based in the EEA and gives their financial participation in other airlines, their code-share partners and franchise operators.

- Star Alliance is the largest alliance involving Austrian, bmi, LOT, Lufthansa, SAS, Spanair and TAP.
  - Star members code-share with 18 airlines, have franchise agreements with 5 airlines and financial stakes in 19 other carriers in the EEA.
- The main Sky Team partners in the EEA are Air France, Alitalia and Czech Airlines.
  - Although Air France and KLM now operate as a single airline, KLM is not yet a member of Sky Team. Note that Aeroflot joined Sky Team in May 2004.
  - Sky Team core members code-share with 23 other airlines, have a franchise agreement with one, and financial stakes in six other EEA carriers.
- oneWorld members are Aer Lingus, British Airways, Finnair and Iberia.
  - BA and Finnair have financial participation in three carriers and franchise arrangements with five. Members code-share with 12 different airlines in the EEA.

- As seen in Table 6, code-share agreements also exist between airlines that are members of different alliances.

See also paragraph 3.3 below on the relative importance of alliance and non-alliance operators at major airports.

***Core alliance airline members based in the EEA currently number 14 airlines.***

### **3.3 Relative Importance of Alliance and non-Alliance Operators at Airports**

- The Star Alliance served 176 airports in the EEA, followed by One World – 145 airports and Sky Team – 134 airports. In percentage terms, 40% are served by Star, 33% by One World and 31% by Sky Team.
- 174 (40%) of 437 airports were not served by any alliance-member airline.

***A high proportion (40%) of airports in the EEA are not served by an alliance carrier.***

### **3.4 City-pairs served**

- There are some potential 95,000 city-pairs in the EEA. Yet only 3,107 unduplicated pairs are directly served by airlines. Travelling between the remaining 92,000 is therefore dependent upon on-line or interline connections.
- Of the total, alliances serve 1,341 unduplicated pairs.
  - Individual alliances serve: Star – 692, oneWorld – 478, Sky Team – 395. Some of these are duplicated pairs and so do not total 1,341.
- Non-alliance airlines serve 2,180 unduplicated city-pairs.

***Only 3.3% of the 95,000 potential city-pairs links in the EEA receive direct air service. Travelling between the remaining 92,000 is therefore dependent upon on-line or interline connections.***

### **3.5 Non-EEA Carriers serving Airports in the EEA**

- 161 airlines from 105 different countries operate to airports in EEA countries (see Table 7).
- Table 7 shows the 120 airlines that participate in the MITA agreements under which they have agreed to accept interline tickets issued by other airlines. They are ranked by the number of passenger 'concurrences' and also show the number of cargo 'concurrences'.
  - 61 non-EEA airlines have agreements to accept interline tickets from over 100 airlines and another 21 with 50-99 airlines.
- A considerable number of non-EEA carriers fly to airports on the territory of the EEA from over two-thirds of the ICAO member states. They make extensive use of interline arrangements to maintain their world networks.

***This data is further evidence of the extent of the network that is created by the IATA multilateral system.***

**Table 1: Commercial Airports and Airlines  
in EEA Member Countries in 2004**

(As at July 2004)

<b>Country</b>	<b>Commercial Airports</b>	<b>Airports with Scheduled Service</b>	<b>Commercial Air Carriers</b>
Austria	8	6	7
Belgium	7	4	4
Cyprus	5	4	2
Czech Republic	8	3	3
Denmark	8	9	6
Estonia	3	1	2
Finland	28	22	2
France	96	60	14
Germany	50	39	19
Greece	44	36	3
Hungary	2	1	2
Ireland	12	9	6
Italy	42	40	21
Latvia	1	1	2
Lithuania	3	3	2
Luxembourg	1	1	1
Malta	2	2	1
Netherlands	6	5	6
Poland	13	11	1
Portugal	22	16	7
Slovakia	7	3	3
Slovenia	3	1	1
Spain	45	40	8
Sweden	50	43	12
United Kingdom	77	59	22
<b>Subtotal</b>	543	419	157
Iceland	36	13	3
Norway	53	49	6
Switzerland	8	7	3
<b>Subtotal</b>	97	69	12
<b>Total</b>	640	488	169

Source:

*IATA City Code Directory*, 42<sup>nd</sup> Edition (Effective 1 April 2004)



**Table 2: Traffic of Airports in EEA Countries**  
(Ranked among the 150 Busiest World Airports in 2003)

Rank	City	Code	Country	Passengers	Seats share by destination	
					inter-continental	regional
EU				'000		
1	London	LHR	UK	63,469	51.20%	48.80%
2	Frankfurt	FRA	Germany	48,352	46.20%	53.80%
3	Paris	CDG	France	48,122	43.80%	56.20%
4	Amsterdam	AMS	Netherlands	39,959	35.30%	64.70%
5	Madrid	MAD	Spain	35,694	15.20%	84.80%
6	London	LGW	UK	30,007	31.30%	68.70%
7	Rome	FCO	Italy	26,285	17.60%	82.40%
8	Munich	MUC	Germany	24,193	21.40%	78.60%
9	Barcelona	BCN	Spain	22,749	2.90%	97.10%
10	Paris	ORY	France	22,390	21.90%	78.10%
11	Manchester	MAN	UK	19,868	22.00%	78.00%
12	Palma	PMI	Spain	19,179	-	100.00%
13	London	STN	UK	18,717	3.60%	96.40%
14	Copenhagen	CPH	Denmark	17,644	16.10%	83.90%
15	Milan	MXP	Italy	17,630	29.90%	70.10%
16	Zurich	ZRH	Switzerland	16,989	28.70%	71.30%
17	Dublin	DUB	Ireland	15,856	7.50%	92.50%
18	Stockholm	ARN	Sweden	15,206	8.50%	91.50%
19	Brussels	BRU	Belgium	15,165	18.80%	81.20%
20	Dusseldorf	DUS	Germany	14,273	12.00%	88.00%
21	Oslo	OSL	Norway	13,647	2.40%	97.60%
22	Vienna	VIE	Austria	12,785	31.80%	68.20%
23	Athens	ATH	Greece	12,252	12.80%	87.20%
24	Malaga	AGP	Spain	11,554	0.50%	99.50%
25	Berlin	TXL	Germany	11,104	3.80%	96.20%
			<b>Subtotal</b>	<b>593,089</b>		
26	Helsinki	HEL	Finland	9,698	-	-
27	Lisbon	LIS	Portugal	9,637	-	-
28	Hamburg	HAM	Germany	9,530	-	-
29	Las Palmas	LPA	Spain	9,181	-	-
30	Nice	NCE	France	9,127	-	-
31	Birmingham	BHX	UK	9,080	-	-
32	Tenerife	TFS	Spain	8,841	-	-
33	Milan	LIN	Italy	8,757	-	-
34	Alicante	ALC	Spain	8,179	-	-
35	Glasgow	GLA	UK	8,132	-	-
36	Geneva	GVA	Switzerland	8,009	-	-
37	Cologne	CGN	Germany	7,758	-	-
38	Stuttgart	STR	Germany	7,585	-	-
39	Edinburgh	EDI	UK	7,482	-	-
40	Prague	PRG	Czech Rep.	7,463	-	-
41	London	LTN	UK	6,810	-	-
42	Lyon	LYS	France	5,940	-	-
			<b>Subtotal</b>	<b>141,209</b>		
			<b>Total</b>	<b>734,298</b>		

Source:  
Airline Business, June 2004

**Table 3: Transfer Traffic at EEA Airports for 2003**  
(Ranked by Percentage of Transfer Traffic)

Rank	Airport	Code	%Transfer Pax	Transfer Pax ('000)	Total Passengers ('000)
1	Frankfurt	FRA	54	25,908	48,352
2	Copenhagen	CPH	42	7,401	17,644
3	Amsterdam	AMS	41	16,342	39,960
4	London	LHR	36	22,752	63,487
5	Zurich	ZRH	35	5,885	16,977
6	Madrid	MAD	35	12,493	35,694
7	Vienna	VIE	34	4,313	12,785
8	Munich	MUC	31	7,450	24,193
9	Athens	ATH	27	3,308	12,252
10	Bodoe	BOO	26	329	1,243
11	Ljubljana	LJU	22	201	921
12	Kirkenes	KKN	22	44	205
13	Oslo	OSL	20	2,700	13,647
14	Tromsoe	TOS	19	261	1,349
15	Caen	CFR	17	17	100
16	London Gatwick	LGW	16	4,783	30,007
17	Milan Malpensa	MXP	14	2,511	17,622
18	London Stansted	STN	13	2,433	18,717
19	Trondheim	TRD	13	344	2,614
20	Lorient-Lann-Bihoue	LRT	13	27	208
21	Barcelona	BCN	12	2,730	22,749
22	Helsinki	HEL	11	1,025	9,708
23	Budapest	BUD	11	530	5,010
24	Manchester (1)	MAN	11	2,185	19,551
25	Prague	PRG	10	741	7,456
26	Aberdeen	ABZ	10	252	2,522
27	Brussels	BRU	9	1,408	15,166
28	Stockholm	ARN	9	1,356	15,206
29	Hammerfest	HFT	9	11	119
30	Bergen	BGO	6	202	3,588

*Legend*

(1) 2001

*Note:*

Statistics are not available for Paris CDG and Orly. Paris CDG is estimated to rank among the top transfer airports.

*Source:*

Airports Council International (ACI)

**Table 4: Airlines based in EEA Countries**  
(Ranked by Number of Passenger Interline Concurrences in 2004)  
~Airlines with 20 or more concurrences~

Country	Airline Code	Airline name	Passenger	Cargo
Italy	AZ	Alitalia	213	152
Switzerland	LX	Swiss	207	144
Ireland	EI	Aer Lingus	197	158
Hungary	MA	MALEV Hungarian Airlines	194	161
Finland	AY	Finnair	192	162
Malta	KM	Air Malta	191	161
United Kingdom	VS	Virgin Atlantic Airways	190	120
Poland	LO	LOT - Polish Airlines	187	151
Portugal	TP	TAP Air Portugal	180	138
Czech Republic	OK	Czech Airlines	177	151
Austria	OS	Austrian Airlines	175	145
Spain	IB	Iberia	172	138
Iceland	FI	Icelandair	172	134
Norway	BU	Braathens ASA	171	-
Sweden	SK	SAS Scandinavian Airlines	169	128
Greece	OA	Olympic Airways	166	126
United Kingdom	BD	bmi british midland	159	143
Netherlands	KL	KLM-Royal Dutch Airlines	159	123
France	AF	Air France	155	140
Cyprus	CY	Cyprus Airways	148	131
Lithuania	TE	Lithuanian Airlines	148	109
Luxembourg	LG	Luxair	147	118
Belgium	SN	SN Brussels Airlines	144	108
Italy	IG	Meridiana	144	105
Slovenia	JP	Adria Airways	140	106
Denmark	DM	Maersk Air	137	91
Germany	LT	L.T.U. International Airways	134	48
Norway	WF	Wideroe's Flyveselskap	126	93
Germany	EW	Eurowings	126	87
United Kingdom	BA	British Airways	125	116
Spain	JK	Spanair	125	70
Spain	UX	Air Europa	120	-
United Kingdom	BE	Flybe British European	113	103
Germany	LH	Lufthansa German Airlines	112	127
Estonia	OV	Estonian Air	106	67
Netherlands	MP	Martinair Holland	106	-
Germany	HR	Hahn Air	104	-
Italy	VA	Volare Airlines	102	-
Portugal	NI	Portugalia	95	58
Italy	EN	Air Dolomiti	95	-
Greece	A3	Aegean Airlines	68	47
United Kingdom	VB	Duo Airways Ltd	65	54
Denmark	QI	Cimber Air	65	11
Germany	AB	Air Berlin	63	-
Latvia	BT	Air Baltic Corporation	61	-
Germany	HF	Hapag Lloyd Fluggesellschaft	53	-
Italy	AP	Air One	51	-
Italy	E8	Alpi Eagles	49	-
Belgium	VG	VLM Airlines	44	-
Italy	ZS	Azzurra Air	42	23
Portugal	LK	Air Luxor	39	26
Italy	G7	Gandalf Airlines	39	-
Lithuania	TT	Air Lithuania	29	-
Sweden	TF	Malmo Aviation	24	-
Portugal	SP	SATA Air Acores	23	-
United Kingdom	GR	Aurigny Air Services	22	-

Sources:

IATA MITA Manual, 70th Edition (Effective 1 April - 31 July 2004)

Official Airline Guide (OAG)

**Table 5: Composition of Alliances showing Financial participation in Partner Airlines and Code-Share Partners (EEA Carriers only)**

<b>Alliance</b>	<b>Airline</b>	<b>Ownership</b>	<b>Codeshare</b>	<b>Franchise</b>
<b>One World</b>	Aer Lingus	-	SWISS	-
	British Airways	100% British Airways CitiExpress, 9% Iberia	SN Brussels, SWISS	GB Airways, Loganair, Sun-air of Scandinavia
	Finnair	49% Aero Airlines	Air France, City Airline, Czech Airlines, Lithuanian, LOT, MALEV, Sun-air of Scandinavia, Golden Air, SWISS, SN Brussels, TAP	-
	Iberia	-	Air France, Czech Airlines, LOT, Maersk Air, SN Brussels, SWISS, TAP	Iberia Regional/Air Nostrum
<b>Sky Team</b>	Air France	100% Régional, Brit Air, City Jet, 11.9%CCM (Corsica), 49% KLM <sup>1</sup>	Adria Airways, Austrian (Tyrolean), British Midland, Estonian Air, Finnair, Iberia, LOT, Luxair, MALEV, Maersk Air, Portugalia, SWISS	British European
	Alitalia	100% Alitalia Express	Air Alps, Air Europa, Air Malta, City Airline, Cyprus Airways, Eurofly, MALEV, SN Brussels	-
	Czech Airlines	-	Air Malta, Finnair, Iberia, KLM, Lithuanian, Lufthansa, MALEV, Sky Europe, SN Brussels, SWISS	-
<b>Star Alliance</b>	Austrian	100% Tyrolean, Austrian Airtransport, Lauda Air	Adria Airways, Air Dolomiti, Air France, Czech Airlines, LH CityLine, Luxair, MALEV	-
	bmi	100% bmibaby	Air France	-
	LOT	100% EuroLot	Czech Airlines, Finnair, MALEV, SN Brussels	-
	Lufthansa	98.8% Air Dolomiti, 30% bmi, 24.9% Eurowings, 13% Luxair, 10% Condor	Adria Airways, Air One, Cimber Air, Cirrus Airlines, Czech Airlines, Maersk Air	Lufthansa Regional (Air Dolomiti, Augsburg Airways, Contact Air, Eurowings, Lufthansa CityLine)
	SAS	100% Blue1 (Air Botnia), Braathens, 99.4% Wideroe's Glyveselskap, 74% Spanair, 47.2% airBaltic, 26% Cimber Air, 25% Skyways, 20% bmi	Estonian Air, Iceland Air, Maersk Air	-
	Spanair	100% AeBal	PGA Portugalia	-
	TAP (Air Portugal)	-	Iberia, PGA Portugalia, SATA	-

<sup>1</sup> KLM is not yet a member of Sky Team.

**Table 6: Code Share relations among EEA alliance member carriers**

Alliance	Airline	Codeshare		
		One World	Sky Team	Star Alliance
<b>One World</b>	Aer Lingus	-	-	-
	British Airways	-	-	-
	Finnair	-	Air France, Czech Airlines	LOT, TAP
	Iberia	-	Air France, Czech Airlines	LOT, TAP
<b>Sky Team</b>	Air France	Finnair, Iberia	-	Austrian, LOT
	Alitalia	-	-	-
	Czech Airlines	Finnair, Iberia	-	Lufthansa
<b>Star Alliance</b>	Austrian	-	Air France, Czech Airlines	-
	bmi	-	Air France	-
	LOT	Finnair	Czech Airlines	-
	Lufthansa	-	Czech Airlines	-
	SAS	-	-	-
	Spanair	-	-	-
	TAP	Iberia	-	-

**Table 7: Non EEA carriers serving EEA**  
(Ranked by Number of Passenger Interline Concurrences in 2004)  
~All Airlines with Concurrences~

Country	Airline Code	Airline name	Passenger	Cargo
Malaysia	MH	Malaysia Airlines	224	190
Korea Republic of	KE	Korean Air	215	164
Brazil	RG	VARIG	204	165
Saudi Arabia	SV	Saudi Arabian Airlines	199	168
Thailand	TG	Thai Airways International	199	162
Cuba	CU	CUBANA	196	162
South Africa	SA	South African Airways	188	159
Chinese Taipei	CI	China Airlines	182	163
Australia	QF	Qantas Airways	180	157
Israel	LY	EL AL Israel Airlines	179	118
Egypt	MS	Egyptair	178	153
Japan	NH	All Nippon Airways	176	161
Jordan	RJ	Royal Jordanian	173	156
Turkey	TK	Turkish Airlines	171	146
Chinese Taipei	BR	EVA Airways	167	150
Tunisia	TU	Tunis Air	166	146
Korea Republic of	OZ	Asiana Airlines	166	137
Bahrain	GF	Gulf Air	165	143
Indonesia	GA	Garuda Indonesia	165	135
USA	US	US Airways	165	108
Canada	AC	Air Canada	164	132
Japan	JL	Japan Airlines	163	133
USA	CO	Continental Airlines	161	118
Ethiopia	ET	Ethiopian Airlines	158	144
New Zealand	NZ	Air New Zealand	158	130
India	AI	Air India	157	133
Colombia	AV	AVIANCA	155	124
Lebanon	ME	Middle East Airlines	153	140
Hong Kong (sar) China	CX	Cathay Pacific Airways	152	132
Morocco	AT	Royal Air Maroc	150	134
Kuwait	KU	Kuwait Airways	146	124
Iran Islamic Republic of	IR	Iran Air	144	129
Seychelles	HM	Air Seychelles	143	125
USA	NW	Northwest Airlines	143	107
Chile	LA	LAN-Chile	142	124
Singapore	SQ	Singapore Airlines	139	119
United Arab Emirates	EK	Emirates	138	121
Qatar	QR	Qatar Airways	138	113
Kenya	KQ	Kenya Airways	132	122
Sri Lanka	UL	SriLankan Airlines	130	123
Yemen	IY	Yemenia Yemen Airways	130	119
Mauritius	MK	Air Mauritius	129	104
Trinidad and Tobago	BW	BWIA West Indies Airways	129	102
USA	DL	Delta Air Lines	127	113
Uruguay	PU	PLUNA	126	103
Brunei Darussalam	BI	Royal Brunei Airlines	124	110
Zimbabwe	UM	Air Zimbabwe	124	91
Jamaica	JM	Air Jamaica	120	104
Namibia	SW	Air Namibia	118	96
Brazil	JJ	TAM Linhas Aereas	118	82
Bangladesh	BG	Biman Bangladesh Airlines	116	106
Croatia	OU	Croatia Airlines	116	89
Angola	DT	TAAG Angola Airlines	115	111
Mexico	AM	Aeromexico	115	98
China	CZ	China Southern Airlines	114	103
China	CA	Air China	112	93
Russian Federation	SU	Aeroflot Russian Airlines	111	97
Viet Nam	VN	Vietnam Airlines	111	68
Pakistan	PK	Pakistan International Airlines	108	105
Ghana	GH	Ghana Airways	107	99

Argentina	AR	Aerolineas Argentinas	100	85
Madagascar	MD	Air Madagascar	99	94
Ukraine	PS	Ukraine International Airlines	98	19
USA	UA	United Airlines	97	100
Algeria	AH	Air Algerie	96	129
Syrian Arab Republic	RB	Syrian Arab Airlines	94	90
Romania	RO	Tarom	88	73
Mozambique	TM	LAM-Linhas Aereas De Mocambique	85	79
Cameroon	UY	Cameroon Airlines	84	79
Serbia and Montenegro	JU	JAT - Jugoslovenski Aerotransport	84	71
Libyan Arab Jamahiriya	LN	Libyan Arab Airlines	82	71
China	MU	China Eastern Airlines	80	65
Israel	IZ	Arkia - Israeli Airlines	72	-
USA	AA	American Airlines	71	183
Bolivia	LB	Lloyd Aereo Boliviano	71	64
Russian Federation	UN	Transaero	67	61
Gabon	GN	Air Gabon	65	57
Ukraine	VV	Aerosvit Airlines	65	51
Sudan	SD	Sudan Airways	59	57
Afghanistan	FG	Ariana Afghan Airlines	59	35
French Polynesia	TN	Air Tahiti Nui	55	30
Moldova Republic of	2M	Moldavian Airlines	50	-
Moldova Republic of	9U	Air Moldova	45	25
Russian Federation	FV	Pulkovo Aviation Enterprise	43	-
Macedonia Former Yugoslav	M4	Avioimpex A.D. P.O.	42	30
Reunion	UU	Air Austral	41	37
Macedonia Former Yugoslav	IN	MAT - Macedonian Airlines	41	30
Ukraine	Z6	Dnieproavia Joint Stock Aviation Co	36	30
Russian Federation	S7	Siberia Airlines	32	-
Russian Federation	E5	Samara Airlines	28	18
Iran Islamic Republic of	W5	Mahan Air	27	17
Faroe Islands	RC	Atlantic Airways Faroe Islands	27	-
Romania	V3	Carpatair	26	-
Bosnia and Herzegovina	JA	Air Bosna	23	18
Serbia and Montenegro	YM	Montenegro Airlines	23	9
Albania	ZY	ADA Air	23	-
Morocco	FN	Regional Air Lines	22	7
Mongolia	OM	MIAT - Mongolian Airlines	21	14
Monaco	YO	Heli Air Monaco	21	-
Argentina	A4	Southern Winds S.A.	20	-
Ecuador	XL	LanEcuador	20	-
Albania	LV	Albanian Airlines	18	13
Djibouti	D3	Daallo Airlines	18	9
Eritrea	B8	Eritrean Airlines	15	11
Kenya	S9	East African SAFari Air	14	-
Guadeloupe	TX	Air Caraibes	13	-
Kazakhstan	4L	Air Astana	11	10
Bulgaria	DU	Hemus Air	11	7
Georgia	A9	Airzena Georgian Airlines	11	3
Azerbaijan	J2	Azerbaijan Airlines	11	-
Russian Federation	U6	Ural Airlines	10	-
Israel	6H	Israir	9	-
Armenia	MV	Armenian International Airways	8	6
Bulgaria	FB	Bulgaria Air	8	6
Libyan Arab Jamahiriya	8U	Afriqiyah Airways	8	4
Russian Federation	7B	Krasnoyarsk Airlines	8	3
Senegal	V7	Air Senegal International	7	1
Venezuela	S3	Santa Barbara Airlines C.A.	6	-
Uzbekistan	HY	Uzbekistan Airways	5	-
Algeria	SF	Tassili Airlines	1	-

Note: 41 Non EEA Airlines serving EEA countries have no passenger interline concurrences

Sources:

IATA MITA Manual, 70th Edition (Effective 1 April - 31 July 2004)

Official Airline Guide (OAG)



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**ANNEX III**

**COMMENTS OF IATA ON  
DG COMPETITION CONSULTATION PAPER CONCERNING  
REGULATION 1617/93**

**A COMPARISON OF IATA AND CARRIER FARES**





## **A COMPARISON OF IATA AND CARRIER FARES**

A comparison of IATA fares to carrier-specific fares is shown in this Annex. The carrier-specific fares shown in the table represent a combination of individually offered carrier-specific fare types from an origin city to an intermediate city and onward to a final destination, via the services of two carriers.

Carrier-specific fares selected for this comparison were those with governing rules that permit the fare to be combined on a single ticket. Travel agents using these fares could issue a single ticket in a single currency and a passenger purchasing such a ticket could check-in to their final destination.

Unlike IATA fares, however, the ability to change routings within mileage limits, to change carriers or to take advantage of both these benefits would not be permitted with these combined carrier-specific fares.

Source for the carrier-specific fares is the Airline Tariff Publishing Company database, as at 30 July 2004.

The carrier-specific fares were selected on the following basis:

- Fares of direct operating carriers only
- Travel permitted in business class
- Fares may have limited seating capacity, controlled by reservation booking designator
- Fares had no significant restrictions such as advance purchase requirements, minimum/maximum stay periods or fees for changes for refunds and/or rebooking.



The following table of 27 sample itineraries illustrates the potential effect on price should IATA interlinable fares no longer be available. Other routing options, including on-line or intra-alliance connecting flights may also be available and these options will result in different total prices. The 27 sample itineraries include an origin in each of the EEA states excluding Leichenstein.

From	travelling on	via	connecting on	To	Currency	IATA Round		Sum of
						Trip Business Fare	Carrier Business Fares	
Aberdeen	bmi British Midland	Amsterdam	KLM	Barcelona	GBP	1,012		
Barcelona	Iberia	London	British Airways	Aberdeen	EUR	1,520	2,179	43.4%
Milan (LIN)	Alitalia	Amsterdam	KLM	Gothenburg				
Gothenburg	Air France	Paris	Alitalia	Milan (LIN)	EUR	1,388	2,191	57.9%
Athens	KLM	Amsterdam	Aer Lingus	Dublin				
Dublin	Aer Lingus	London	British Airways	Athens	EUR	1,444	1,555	7.7%
Copenhagen	SAS	Madrid	Iberia	Santiago Comp	DKK	12,065		
Santiago Comp	Iberia	Brussels	SAS	Copenhagen	EUR	1,623	2,389	47.2%
Vienna	Air France	Paris	Icelandair	Reykjavik				
Reykjavik	Icelandair	Copenhagen	Austrian		EUR	2,221	2,400	8.1%
Brussels	SN Brussels	Copenhagen	SAS	Tampere				
Tampere	SAS	Stockholm	SN Brussels	Brussels	EUR	1,833	2,280	24.4%
Helsinki	Finnair	Copenhagen	Luxair	Luxembourg				
Luxembourg	Luxair	Frankfurt	Finnair	Helsinki	EUR	1,803	2,172	20.5%
Bordeaux	Air France	Paris	Austrian	Vienna				
Vienna	Austrian	Munich	Lufthansa	Bordeaux	EUR	1,499	1,796	19.8%
Hamburg	Lufthansa	Paris	Air France	Porto				

From	travelling on	via	connecting on	To	Currency	IATA Round		Sum of
						Trip Business Fare	Carrier Business Fares	
Porto	TAP	London	British Airways	Hamburg	EUR	1,932	2,509	29.9%
Reykjavik Eindhoven	Icelandair	Amsterdam London	KLM Icelandair	Eindhoven Reykjavik	ISK EUR	140,486 1,595	1,615	1.3%
	Aer Lingus Maersk Air	Copenhagen London	SAS Aer Lingus	Billund Dublin	EUR	1,129	1,151	1.9%
Luxembourg Bergen	Luxair SAS	Manchester Copenhagen	SAS Luxair	Bergen Luxembourg	EUR	1,469	1,934	31.7%
	KLM Alitalia	London Paris	bmi British Midland KLM	Naples Eindhoven	EUR	1,552	1,975	27.3%
Stavanger Malta	KLM British Airways	Amsterdam London	Air Malta SAS	Malta Stavanger	NOK EUR	10,895 1,283	1,974	53.9%
	TAP Lufthansa	Amsterdam Brussels	Lufthansa TAP	Hamburg Lisbon	EUR	1,942	2,270	16.9%
Barcelona Birmingham	Iberia SN Brussels	Paris Brussels	Air France Iberia	Birmingham Barcelona	EUR	1,463	2,052	40.3%
	Lufthansa SWISS	Frankfurt Zurich	Olympic SAS	Thessaloniki Stockholm	SEK EUR	17,510 1,903	2,272	19.4%
Larnaca Hamburg	Cyprus Airways Lufthansa	Athens Vienna	Lufthansa Cyprus Airways	Hamburg Larnaca	CYP EUR	950 1,632	2,046	25.4%
	Czech Airlines TAP	Paris Milan	TAP Alitalia	Lisbon Prague	CZK EUR	56,290 1,795	2,384	32.8%
Tallinn London	SAS bmi British Midland	Copenhagen Frankfurt	British Airways Lufthansa	London Tallinn	EEK EUR	31,660 2,023	2,029	0.3%

<b>From</b>	<b>travelling on</b>	<b>via</b>	<b>connecting on</b>	<b>To</b>	<b>Currency</b>	<b>IATA Round</b>		<b>Sum of</b>
						<b>Trip Business Fare</b>	<b>Carrier Business Fares</b>	
Budapest Dublin	British Airways Air France	London Paris	Aer Lingus MALEV	Dublin Budapest	HUF EUR	360,900 1,444	1,821	26.1%
Riga Oslo	Air Baltic SAS	Helsinki Stockholm	Finnair Air Baltic	Oslo Riga	LVL EUR	832 1,256	1,368	8.9%
Vilnius Milan	Lithuanian Airlines Austrian	Berlin Vienna	Alitalia Air Baltic	Milan Vilnius	LTL EUR	4,914 1,423	1,755	23.3%
Malta Stockholm	Alitalia Czech Airlines	Rome Prague	SAS Air Malta	Stockholm Malta	MTL EUR	550 1,290	2,107	63.3%
Warsaw Madrid	LOT Iberia	Paris Frankfurt	Air France Lufthansa	Madrid Warsaw	PLN EUR	6,192 1,395	2,394	71.6%
Bratislava Helsinki	Czech Airlines LOT	Prague Warsaw	Finnair Slovak Airlines	Helsinki Bratislava	SKK EUR	64,890 1,626	1,866	14.8%
Ljubljana Lyon	Adria Airways Air France	Zurich Vienna	Air France Adria Airways	Lyon Ljubljana	EUR	977	1,461	49.5%



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**ANNEX IV**

**COMMENTS OF IATA ON**

**DG COMPETITION CONSULTATION PAPER CONCERNING  
REGULATION 1617/93**

**THE RESTRICTIVE EFFECTS OF THE IATA TARIFF CONFERENCE  
SYSTEM: AN ECONOMIC ASSESSMENT  
BY CHARLES RIVER ASSOCIATES**



## **Annex IV**

# **The Restrictive Effects of the IATA Tariff Conference System: An Economic Assessment**

**By**

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# The Restrictive Effects of the IATA Tariff Conference System: An Economic Assessment

## INTRODUCTION

On 30 June 2004, DG Competition published a consultation paper concerning the revision and possible prorogation of Commission Regulation 1617/93 on the application of Article 81(3) to IATA tariff conferences for passengers and cargo. The Consultation Paper analysed the IATA tariff conferences in terms of their restrictive effects and the potential benefits from enabling passengers and cargo to pass onto the networks of different airlines in the context of the IATA multilateral system. Charles River Associates (CRA) has been asked by the International Air Transport Association (IATA) to analyse the theoretical and empirical basis for DG Competition's claim that the IATA tariff conferences restrict competition and to analyse the possible benefits and extent of interlining within Europe and between Europe and the rest of the world. This paper analyses the possible restrictive effects of the conferences.

## VIEW SET OUT IN THE CONSULTATION PAPER

The Consultation Paper asserts that IATA tariff conferences restrict competition within the meaning of Article 81(1) EC for the following reasons:

*43. Without prejudice to the legal question whether IATA Tariff Conferences may be considered a restriction of competition by object in the meaning of Article 81(1), the services of DG Competition take the preliminary view that they actually restrict competition. The underlying rationale for this consideration is that an IATA interlinable ticket to fly from A to B is comparable to a carrier specific ticket to fly from A to B (where such a carrier specific ticket exists) in so far as both tickets entitle a consumer to travel by air from a point of origin to a point of destination. The differences lay in product differentiation, i.e. additional flexibilities/frills which the one or the other may have.*

*Because a pricing structure must in the long run remain coherent with the product offering it relates to and therefore adequately reflect product differentiation, where one or more carrier and/or airline alliance serve a given route, those carriers/alliances have no choice but to give appropriate consideration to the level of IATA fares on that route and to the conditions attached thereto.*

*The restriction of competition flows from the unavoidable consideration given by airlines to the coordinated level of IATA fares.*

*44. Moreover, IATA Tariff Conferences provide a forum wherein airlines exchange information on costs, prices and general industry developments, which can only reinforce the above mentioned restrictive effects.*

CRA reads paragraphs 43 and 44 of the Consultation Paper to raise two theoretical concerns.

The first is that IATA and on-line fares are differentiated products, which must have some necessary relationship to one another based on product quality. The second is that through the



operation of the IATA Tariff Conferences the member airlines gain a better knowledge of the private strategies of each airline which leads to coordination (tacit or explicit) on the level of each carrier's fares (as well as the "coordinated" IATA fare). In the 2001 consultation exercise DG Competition referred to it as the "coat-hanger" effect of IATA tariff setting on business fares.

CRA notes that the current Consultation Paper contains no empirical analysis or data and does not reference any analysis to support the allegations made that the IATA tariff conference restricts competition.

CRA concludes in this paper that as a matter of theory it is probable that there will be some interaction between IATA and carrier fares, but it not necessarily that case that it will result in increased prices and even if it does it cannot be assumed that it is anticompetitive (demand interaction is pro-competitive). We consider that the Consultation Paper cannot simply assume anti-competitive effects arising from price interaction between the IATA product and the carrier flexible business class fare. Moreover, any such impact may also be felt on other carrier fares, including economy class fares. CRA also concludes that the information exchange between carriers within the IATA conferences is unlikely to facilitate tacit coordination between the airlines, notwithstanding that both business class travel and cargo are not conducive to such coordination in the first place.

In the next section of this paper CRA describes the IATA fare setting process and looks at how airlines price their own fares. A full understanding of the IATA tariff-setting mechanism and of the very different approach taken by individual airlines to setting their own fares helps to explain why there is no necessary relationship between the two processes. CRA then examines the theoretical and empirical basis for both allegations contained in paragraphs 43 and 44 of the Consultation Paper.

## **THE IATA FARE SETTING PROCESS**

IATA tariff conferences for both passenger and cargo are there to facilitate interlining on a comprehensive worldwide basis. Interlining is the ability of a passenger to use a single ticket in a single currency to travel on more than one airline on a route and even to change airlines and routes. The ability to do this in the IATA context is not in the scope of any one airline and this means that some mutually acceptable mechanism is required for airlines to accept passengers from other airlines. CRA has produced a companion paper for this consultation process which examines these interline benefits for consumers.

Cooperation between airlines can produce economic benefits and especially in network industries. Airlines are examples of production networks where there are economies of scale and scope. Following deregulation in the EC, airlines have begun to exploit these economies of scale and scope through the creation of alliances and hub and spoke systems which allow the use of





larger aircraft and network coverage. An airline would prefer that passengers use its service for their entire journey, but they also want to obtain the economies of density on its own network by carrying passengers from other airlines. Interlining increases the economies of density and allows for a wider number of city-pair destinations to be accessed with much higher frequencies through a single ticket. IATA conferences determine the basis on which interlining passengers are accepted when alliances and bilateral agreements are insufficient to satisfy the network scope or flexibility required by the passengers and therefore the IATA multilateral option is chosen. The cooperative solution arrived at via the IATA conference mechanism therefore concerns access to another's airline's network that would otherwise not have taken place or in terms of higher costs and inconvenience.

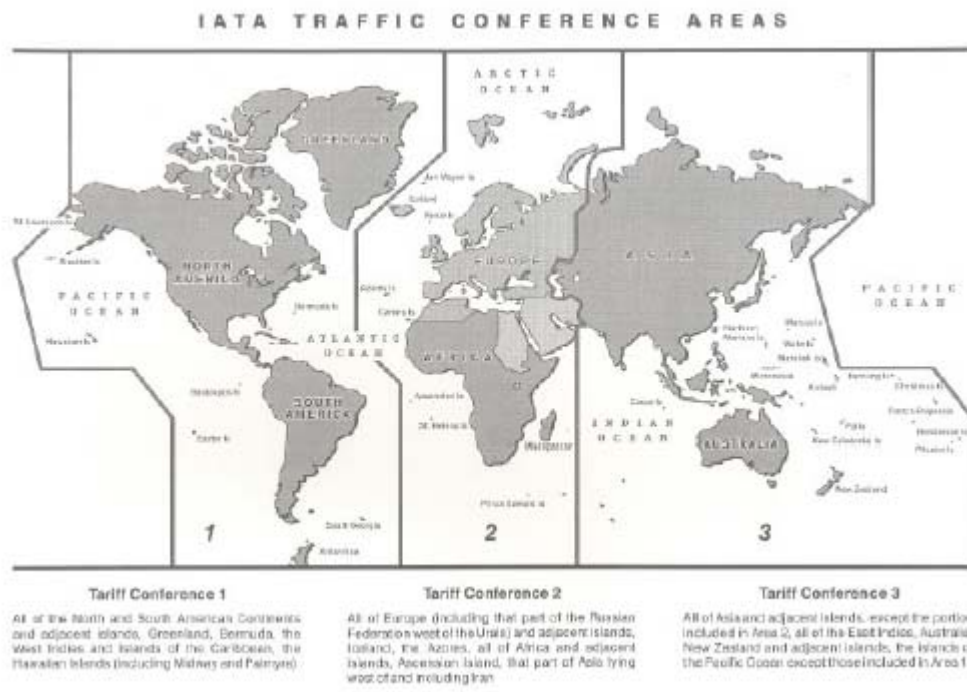
Under the current Block Exemption IATA manages a system of multilateral interlining in which any airline may participate allowing any participating airline to interline with other participants at 366 destinations within the EEA and for 1430 destinations to and from the EEA, and can interline with each other at the rates set in these conferences. The conference covering intra Europe routes currently has 32 EEA participants and includes sixteen regional airlines and has met twice in 2003 to address intra-EEA tariffs and once each for the Europe – Middle East, Europe – Africa, Canada / US – Europe, Mexico-Europe, Mid-Atlantic / South-Atlantic – Europe, Europe – South Asian Subcontinent / South West Pacific, Europe – South East Asia, Europe – Japan / Korea and the composite. The conference for routes between Europe and North America has 60 member airlines. In all 128 airlines use the IATA conference system to allow multilateral passenger interlining, 95 for cargo interlining.

**Table 1: Conference areas – voting member counts**

Conference Area	Voting Members	EEA based Voting Members
<b>Passenger</b>		
TC2	77	32
TC12	60	20
TC23	69	15
World-wide	128	32
<b>Cargo</b>		
TC2	56	20
TC12	51	16
TC23	58	12
World-wide	95	20

*Source: IATA.*

Note that TC2 includes within Europe and between Europe and Africa Middle East, TC12 includes between Europe and the Americas, and TC23 includes between Europe and Asia, Pacific. This is shown below:



The tariff conferences for both passenger and cargo are similar. We first set out how IATA fares are set for passengers and then detail any differences cargo conferences might have.

Meetings of the Tariff Conferences are held in accordance with formal rules set out in the Provisions for Conduct of the IATA Traffic Conferences. Proposals to amend the existing agreement must be made in accordance with fixed deadlines and are only adopted upon the unanimous affirmative vote of the participants present. Normally each proposal is considered and dealt with to conclusion in a plenary session. This is also the case for the meeting dealing with passenger fares within the EEA, however due to the complexity of this area some proposals may not be finalised in plenary and may also be discussed in country-by-country sessions where a smaller group of delegates can review the proposal and possibly develop a compromise position. Any recommendation of a country-by-country session is presented to the plenary for adoption. The need for country-by-country sessions is illustrated by the fact that IATA fares exist for 366 destinations in 51 States and Territories. IATA fares also exist to 1430 destinations outside of the EEA. In all cases every participant has a veto. Fares and rates in the agreements may also be amended between meetings through a process<sup>1</sup> where proposals are made to IATA by e-mail or telex. IATA then seeks to obtain unanimous agreement from all other participants by e-mail or

<sup>1</sup> For passengers there can be resolutions in the 001 series which permit participants to propose changes to tariffs between meetings; for cargo the equivalent is the 116 series of resolutions



telex messages. In both cases, every member of an IATA conference has a veto and vetoes are frequently used as can be observed from the minutes of the tariff conferences provided to the Commission.

By and large the cargo and passenger conferences operate in a similar way. We understand however that the cargo conferences meet much less often than for passenger tariff setting. Between meetings changes to individual rate levels, including the introduction or cancellation of specific rates<sup>2</sup>, are accomplished under the provisions of the resolutions in the 116 series as described above. For cargo most of the changes involve the introduction of new routes such as to and from growth areas such as China. These resolutions do not permit the introduction or cancellation of new products or changes to industry tariff standards and procedures, which may be addressed only by the full conference or by a more formal mail vote.

Because of the need to submit agreements to regulatory authorities these meetings are held as much as six months in advance of the intended effective date of any changes. The fares and rates established in the conference (and resolution) process are available for travel on services operated by the participants. However the IATA system is not exclusionary, other airlines who wish to interline can also participate through the Multilateral Interline Traffic Agreement (MITA). When issuing tickets or waybills using IATA fares and rates they do so in the knowledge that the IATA participants will accept its passengers and shipments at the amount collected. Industry fares do not limit participants from undertaking on-line, or alliance, fare initiatives. As government policies have changed in recent years it is now the case that many routes have IATA, carrier-specific on-line, and alliance fares and rates.

## **AIRLINE PRICING STRATEGIES**

The systems airlines use to determine their own carrier fares are complex. Carrier on-line pricing is theoretically set based upon a multitude of factors, which may include, but is not limited to the following:

- Current economic conditions within the country of sale.
- Carrier economic cost factors.
- Competitors fare levels.
- Distribution channel variances.
- Traffic demand on the specific segment.

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<sup>2</sup> Other changes include introduction or amendment to 'break-points' establishing volume discounts; amendments to industry add-on amounts; changes to local currency charges; etc.



An airline will typically have a multitude of fares for any market. Price variances with competitors may be acceptable or deemed unacceptable in a particular market based on market intelligence, competitive environment and customer preference factors. Each individual market has different competitive variables, but the common theme will be the need to match a price level with customer demand for the different fare products that cater to vastly different customer needs. Revenue Management techniques also allow carriers to offer competitive pricing while at the same time limiting that product if it is deemed to be diluting the overall revenue generation on a particular flight segment.

The market for airline tickets is thought to be particularly transparent given the ready availability of published fares through modern CRS systems. That transparency has been both enhanced and diminished by recent developments, as airlines have been increasingly selling their tickets directly to their customers via, for example, their own internet sites and by the proliferation of contractual corporate arrangements with companies. The point being that whilst there are aspects of the market that are transparent to all, other competitive aspects such as business travel are increasingly conducted with contract arrangements that may substantially differ between customers and between airlines. In other words, the effective fares in a market for two airlines offering a similar product may differ substantially including in those cases where IATA fares appear on the ticket but where a corporate discount is later applied on the basis of actual travel on an airline with which the company has an contractual agreement.

This section has described how IATA and carrier fares are determined by airlines through coordinated and unilateral action respectively. Carriers today react to individual market conditions faster than can be achieved under the IATA tariff conference system, for both passengers and cargo. Even though resolutions may change IATA tariffs, the systems is not suited or designed to react to the constant adjustments that characterize carriers' pricing strategies. The next section analyses the Consultation Paper's allegation that, in effect, these two ways of determining fares are linked such that competition is restricted.

## **PRODUCT DIFFERENTIATION**

In this section we consider the differentiated product issue raised in paragraph 43 of the Consultation Paper from a theoretical perspective. This section seeks to show that any relationship seen between IATA fares and carrier's business class fares is based upon supply and demand considerations rather than a restriction of competition. First we consider general product differentiation theory, in particular looking at the implications of product differentiation for relative pricing. Following this, we consider more formally, using simple microeconomic models, how shifts in the price of one product affect the market for a second product that is an imperfect (or partial) demand-side substitute. We then move on to two issues specific to the airline context that arise because different classes of travel are 'jointly produced', with many of the costs of the service being common across fare types. The issues covered are the prevalence of demand-based pricing, and the implication of a zero-profit condition across the joint platform, a condition imposed by market competition.

### *Product differentiation*

As we understand it, the Consultation Paper seems to start from the premise that an IATA fully flexible interline fare and a carrier's own on-line fare are differentiated products when offered on the same route, given the different product features of the two. This is a reasonable position. However, the Consultation Paper then seems to suggest in the second part of paragraph 43 that the two products will necessarily have a given relationship between each other dictated by the difference in product quality. In other words if fare A is the IATA fare and fare B the carrier on-line fare, then B must *necessarily* be set at A minus the difference in price justified by the reduced flexibility of the on-line fare.

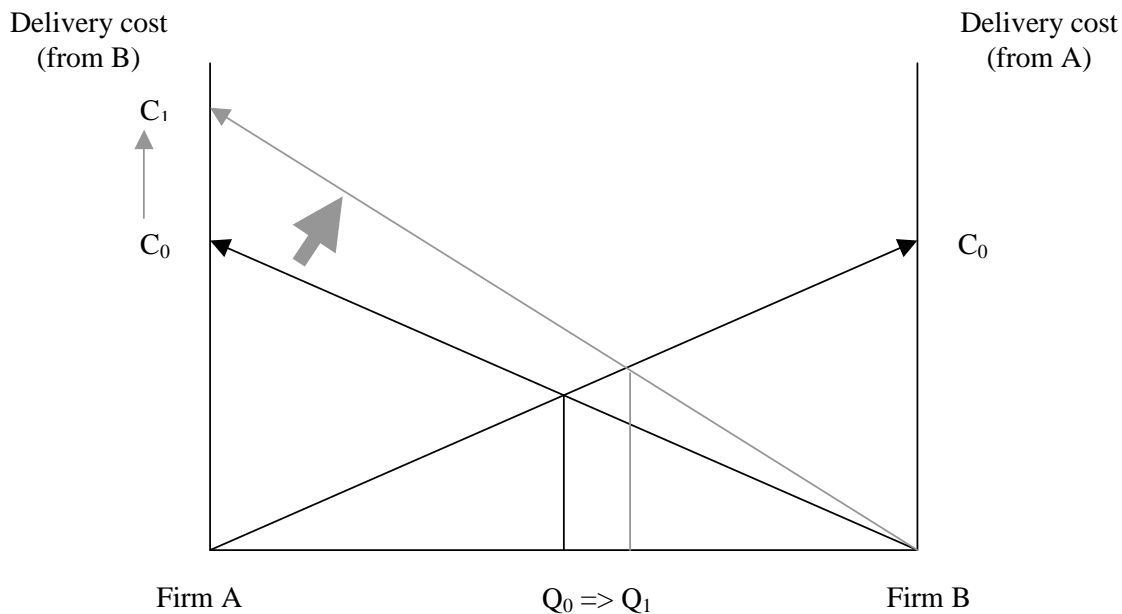
In the following analysis we consider the issue of the impact of product differentiation on the price positioning of differentiated goods. Initially we do this by considering two generic goods, A and B, that are partial demand-side substitutes, and assuming (initially) that both goods are supplied by multiple suppliers in competitive markets. We subsequently consider issues that arise when simple modifications are made to the assumptions, with a particular view to the commercial air transport pricing issue DG Competition is considering.

It is certainly true that an optimising monopolist supplying two differentiated goods A and B (that is, goods that are partial rather than perfect substitutes) would choose to set the price of A and B at the price difference that optimises the monopolist's profits, and any greater or less price difference would by definition lead to a fall in profits. However, in general it is not the case that if A was priced too high relative to its optimal price, that product A would not exist and its demand would fall to zero. Nor is it the case if product A was priced too low that it would

capture all of B's volume and demand for B would fall to zero.<sup>3</sup> This is because differentiated products generally have downwards-sloping demand curves, made up of many consumers with different preferences, and hence different individual price/value trade-offs associated with particular product features. When the relative prices shift there will be substitution between them—some consumers will change from purchasing one to the other—but only partial substitution will occur.

Basic economic models of product differentiation often start with one simple point of differentiation, the cost of transport. The model depicted below shows two firms selling an otherwise identical product, except for the cost of transport. For simplicity, the firms are at the extremities of the market, which consists of the space between A and B. Consumers are assumed to be evenly distributed over this distance. For simplicity, each firm charges the same price for the good, plus a delivery charge that is dependant upon the distance from the firm to the consumer. Both firms charge an identical per kilometre charge for delivery. Under these circumstances the market is evenly split between the firms, at the point  $Q_0$ . Consumers to the left of  $Q_0$  buy from A, and to the right from B.

**Figure 1: Product Differentiation – Transport Cost Model**



Now, imagine that firm B increases its delivery charge. The cost of purchasing from B increases (maximum delivery charge increases from  $C_0$  to  $C_1$ ). The impact of this is that, all else equal, some consumers will now substitute to firm A. The split in the market is now at  $Q_1$ . Firm A sells increased volumes, while firm B sells lower volumes.

<sup>3</sup> All else equal, if A was considered the superior product by all consumers this could still only be assumed to happen if A was priced at less than B.



Does the analysis above imply any change in the relative prices offered by firms A and B, aside from the transport cost charge? This depends upon the model of competition assumed. In the case of fully competitive markets, there will be no other changes. To see this, assume that A and B are not individual firms, but competitive clusters of suppliers in different locations. If this is the case, the good will be supplied at cost (as in all fully competitive market models),<sup>4</sup> including the cost of delivery which is a differentiating factor due to location differences. If the price increase from market B is due to an increase in transport costs from that market,<sup>5</sup> there will be no change in product prices, and volumes sold will shift to reflect the relative change in costs.

Another scenario of interest in this case is what if market B was competitive, but firm A was a local monopoly? In this case, supply from market B will remain on the basis of cost, and consumers previously supplied by B (those right of  $Q_0$ ) will be supplied at the same price, and will remain with B. However, those to the left of  $Q_0$  will see changes. The monopoly firm A will have scope to increase price, given the competitive ‘shelter’ offered by transport costs from B. Firm A will increase price, and some of the customers previously supplied from A will either cease to purchase, or will purchase from market B (and in the process incur an inefficient level of transport costs).

The key point is that because consumers have individual ‘preferences’ (in this case, modelled using the cost of delivery associated with location), relative price changes result only in *partial* substitution between firms, not full substitution. Changing the x-axis of the analysis from transport costs to different consumer preferences for different characteristics of goods produces the same result. Changes in relative prices will change relative shares of the overall market captured by different goods, but assuming competitive supply of both goods, the price of each will remain at the overall cost of production in the long run. This point is further illustrated in the model below.

### *Product differentiation in merger analysis*

Because most competition authorities commonly deal with product differentiation in the context of mergers, it is perhaps briefly worth considering what the approach taken in mergers reveals about the pricing relationship between differentiated products.

In mergers, the issue of interest is usually in one of two broad forms. The first is a merger in product A which raises an issue as to whether there is sufficient competition from product B, a differentiated product that is an imperfect substitute for A, to prevent the potential for the exercise of market power in product A absent co-ordination with suppliers of B. The second is

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<sup>4</sup> The term ‘cost’ here is used to describe prices that equal average total cost in the long run. That is, the price at which no economic rents remain in the market in the long run.

<sup>5</sup> For the sake of simplicity, it is assumed domestic transport must be used. This assumption is not essential of course. We could equally hypothesize an increase in the cost of the good itself due to local cost changes. The analysis would remain the same.



where the merger involves firms supplying both A and B. In both cases to conclusively answer the question of whether prices might increase post merger requires an analysis of customer switching, and a diversion ratio analysis.<sup>6</sup> The key inputs are estimates of the margin on product A, and the share of sales that would divert to B for a given price increase. Given these elements, it is possible to calculate whether a particular hypothesised price increase would likely be profitable or not.

The key point is that this analysis only makes sense if the prices of the differentiated products are able to diverge. If the price difference between A and B were somehow fundamentally fixed by the price/value relationship between the two, the analysis would be meaningless. The prices would move together, and there would be no change in relative prices. The implication of this is that B would never constrain a price increase in A, because it would have to ‘track’ the price of A. Of course, this is not the case. The prices normally can move independently.<sup>7</sup> Whether or not the merging firm has the ability and incentive to increase prices requires analysis. It cannot be assumed that prices of imperfect substitute products move in unison.<sup>8</sup>

#### *Is the model relevant to airline markets?*

The general analysis above applies in situations where goods are differentiated in one or a number of ways, and consumer preferences for the product characteristics vary. This differs from a situation where two goods are close to perfectly homogenous from the perspective of technical substitution, but have different performance on a critical feature that has a *completely objective valuation* (that is, the difference in value can be precisely calculated, and the value is the same to all consumers that purchase the product). For example, imagine two hypothetical fuels for vehicles, A and B. Fuel B is a perfect substitute for A in every respect, except that it provides 20% more value (vehicles running on B can travel 20% further for the same volume). If consumers had full information, then they would never buy fuel A if B was only 10% more expensive than A. Likewise they would never buy B if it was 30% more expensive, all else equal. Under these assumptions, the price difference between the two products would have to exactly equal the value difference for both products to co-exist in the market; otherwise one or the other would dominate. This situation does exist at times, but it certainly does not apply to air travel, where different consumers (even of a particular ticket type) will put different valuations

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<sup>6</sup> This also needs to be followed by an analysis of dynamic competitive responses.

<sup>7</sup> In particular, if the market for B is fully competitive it is reasonable to assume its price will remain reasonably constant in the long term. Where this is not the case, or where the products are supplied by individual firms, this does not hold. Merger oligopoly models specifically model the price interactions that occur in such cases. We consider this issue (where price effects occur) in further detail below, using the limiting case of fixed supply. Other models are of course entirely possible as intermediate cases.

<sup>8</sup> It is of course necessary to follow this analysis with consideration of the potential for competitive entry and strategic behaviour. However, this is the next step, and one that reflects the importance of behavioural issues in assessing the potential trajectory of relative prices of differentiated products.





on features such as expected journey time, ticket flexibility, and so on. As a result, we believe the standard differentiation model discussed is directly relevant to this case.

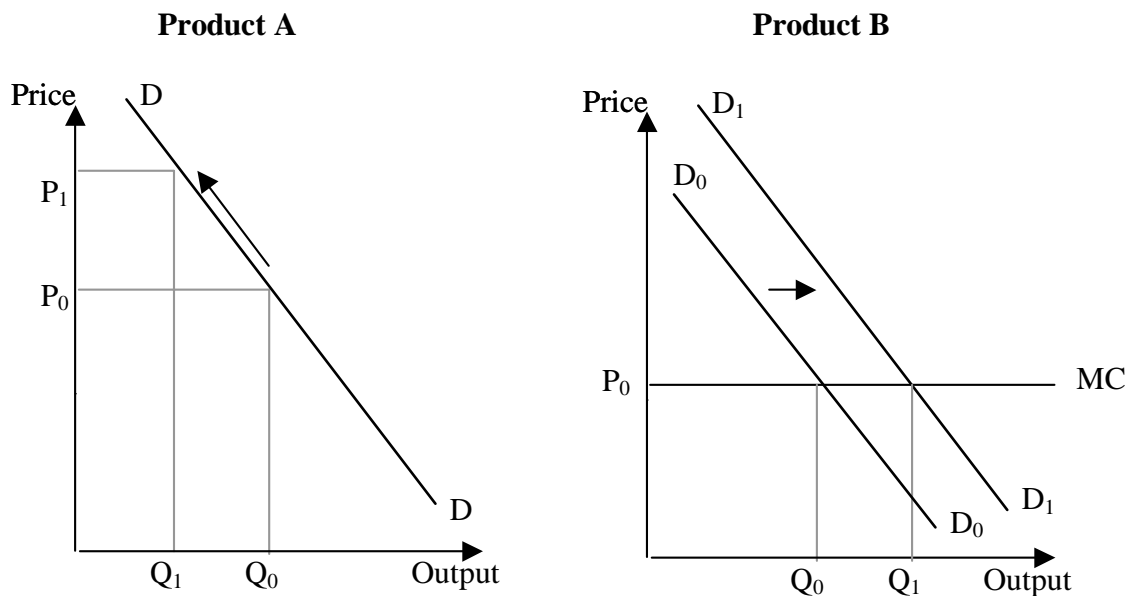
*IATA and Airline fares as differentiated products*

The Consultation Paper raises questions relating to IATA and airline (including alliance) fares as differentiated products, questioning the relationship that might therefore exist between the pricing of these fares. In our view, microeconomic theory can generate some basic insights that are useful when considering the potential relationships. Before considering some of the complexities of actual airline pricing, it is worth considering the general relationship between two products that are imperfect substitutes. Initially we consider the simple case where the two products are independently produced. The only interaction is limited demand-side substitution. We consider two polar cases, absence of barriers to expansion and fixed capacity constraints in the market. Both are likely to be relevant in aviation in different circumstances.

*No capacity constraints*

In the first case we consider two products, A and B. They are imperfect substitutes, so an increase in the price of A will lead to some substitution to product B, and vice versa. In the context of the Consultation Paper’s current inquiry, the issue is what happens to the price of product B, if for example the price of A increases? Figure 2 below depicts the analysis.

**Figure 2: Substitution – No Capacity Constraints**





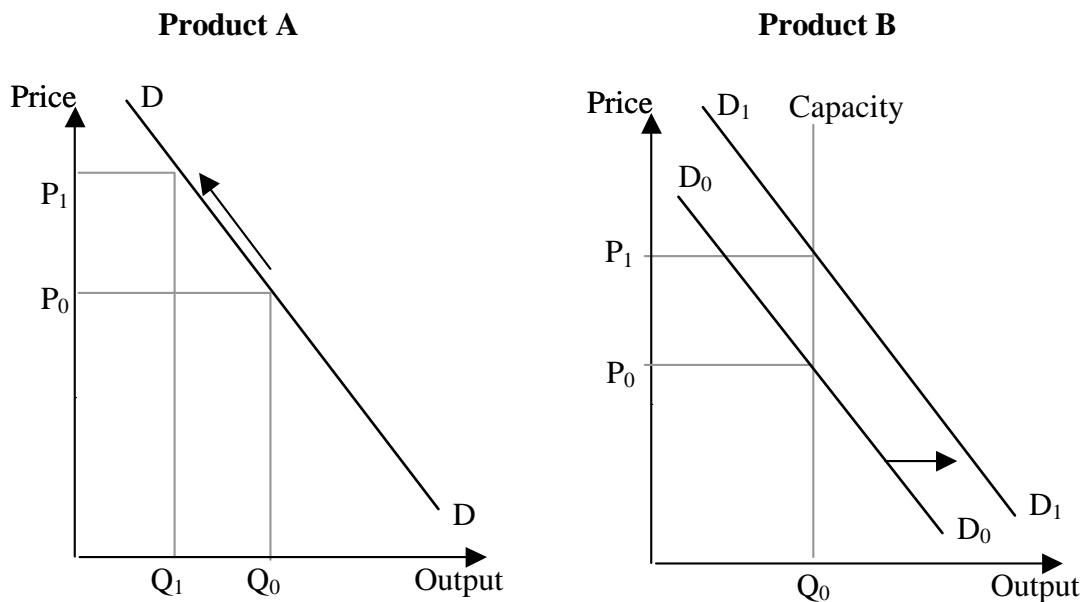
Initially, the price of product A increases from  $P_0$  to  $P_1$ . Volume of product A sold decreases from  $Q_0$  to  $Q_1$ . Some of the lost volume will represent sales no longer made, while some will substitute to product B. This increases the demand from  $D_0$  to  $D_1$ . Assuming no capacity constraints, no fixed costs (for simplicity), and a competitive market for B, then any amount of product B will be supplied at price  $P_0$ . The volume of B sold increases to  $Q_1$ , while the price remains at  $P_0$ .

This analysis more formally depicts the arguments made above that, assuming competitive markets with no capacity constraints (in this case for product B), relative price changes will affect the volume of sales of, but not the market price for, product B. Price is set by production costs, whilst volume is dictated by demand, which in the case of differentiated products is also driven by the supply and demand conditions of other products (A in this case). Note that whether the increase in the price of A is due to increases in the cost of A or an exercise of market power makes no difference to the analysis for product B.

*Capacity constraints*

Introducing capacity constraints fundamentally alters the analysis. As before, there is a rise in the price of product A, but in this case there is a fixed constraint on the amount of capacity available in the market for product B. This is depicted below in Figure 3.

**Figure 3: Substitution – With Capacity Constraints**





In this case the capacity constraints means that the increase in demand will transfer entirely into a price increase, from  $P_0$  to  $P_1$ , with no movement in quantity supplied. Under these circumstances, price of B is set by demand for B, given the capacity available.

### *Summary*

Although the above analysis is simplified as much as possible, nonetheless there are useful insights for the conclusions posited in the Consultation Paper. The first is that if product A above was thought of as IATA fully flexible business fares, whereas B was airline (or alliance) on-line business fare, it cannot be simply assumed that there will be a ‘coat-hanger’ effect between the price of A and B caused by the two being differentiated products that are imperfect substitutes. If the price of B is set in competitive markets without other constraints, the price of B will be set by production cost, but the price of A will affect the volume of B. If on the other hand it is thought that capacity constraints are an issue in market B (perhaps because of airport capacity limitations), then the price of A will be positively correlated with the price of B.<sup>9</sup> However, this simply reflects the interaction of supply and demand in a competitive market. Finally, note that if product A was entirely removed from the market, it would result in the price of B being even *higher*, not lower, as even more demand would be diverted to B.

### *Joint production*

For the purposes of achieving analytical clarity, the analysis above treated A and B as separate products from a supply-side perspective, that is, it implicitly assumed unrelated production platforms. However, airfare pricing is more complex, as airfares of different types are differentiated products but produced on a platform where the bulk of the costs are common across all fare types offered on a particular flight.<sup>10</sup> When significant levels of common costs are involved price setting will necessarily require consideration of demand-side factors. Laffont and Tirole (2000) note that:<sup>11,12</sup>

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<sup>9</sup> That is, increases in the price of A will cause an increase in the price of B, and vice versa.

<sup>10</sup> It would be easier to specify the costs that are *not* common to other ticket types, such as business lounges and the cost of the higher service level in the cabin, than to list those which are common.

<sup>11</sup> Laffont, J.J and J. Tirole, *Competition in Telecommunications*, MIT Press, 2000, p.132.

<sup>12</sup> As an important aside, it is worth noting that there is increasing acceptance that such behaviour not only does not provide any evidence of market power, but is actually a necessity under competition when significant fixed or common costs are present. As a recent example, Baumol and Swanson (2003) note in their article on ubiquitous competitive price discrimination that ‘... in the presence of scale economies competitive market forces will virtually force all firms to adopt discriminatory prices if customers or sales can readily be separated into distinct and non-trading compartments’. See Baumol and Swanson, *The New Economy and Ubiquitous Competitive Price Discrimination*, Antitrust Law Journal Vol. 70 Issue 3, 2003.



*'...[unregulated businesses] engage in sophisticated marketing strategies. They offer discounts to high-elasticity-of demand customers, adjust their prices to competitive pressure, and carefully coordinate the pricing of substitutes or complements. The structure of unregulated firms' prices (though not the level if the firms have substantial market power) thus reflects Ramsey-Boiteux precepts. This observation suggests that the most promising alley for implementing Ramsey prices in a regulatory context is to decentralize pricing decisions to the operator.'*

Unfortunately pricing in such an environment is complex. Problems such as estimating socially efficient prices, or precisely forecasting the impact of market shocks on competitive prices in markets with complex demand-driven price menus are particularly difficult. So much so that regulators have generally accepted that attempting to undertake such tasks is counter-productive. As Laffont and Tirole note:<sup>13</sup>

*'The idea of decentralizing pricing decisions may be foreign to those who favor heavy regulatory intervention. Yet, a key feature of the regulatory revolution of the 1980s was departure from the detailed setting of individual prices and flexibility to operators to adjust their price structure to demand and competitive pressure conditions.'*

Nonetheless, while precise predictions may not be possible at the general level, there are at least two general propositions that are worthy of consideration in the context of DG Competition's consideration of IATA fares and their relationship with general fare levels. These are, the likely impact on relative prices given changes in relative demand, and the impact of the shared platform operating in a competitive market on the relative prices of A and B if one of those prices is altered for any reason other than a change that precisely reflects a change in variable costs relevant to that product only.

First, the impact of demand-based pricing. As argued by Laffont and Tirole above, demand-based pricing tends to lead to market prices that are efficient (that is, in line with Ramsey-Boiteux precepts). In other words, margins over variable cost tend to be set higher for those identifiable segments with relatively inelastic demand, and conversely low for those with relatively elasticity demand. This is observed in many markets with common examples including segmented prices for children, students and the aged for services as varied as haircuts and cinema tickets, through to hotels that increase prices in periods of high demand and discount at off-peak times. Airline pricing is commonly mentioned as an example of a competitive market that exhibits complex tariffs that allow price discrimination.<sup>14</sup>

The presence of demand-based pricing suggests that if increases in IATA fares leads to substitution to carrier business fares (the closest substitute), this may produce an increase in

<sup>13</sup> Laffont, J.J and J. Tirole, *ibid*.

<sup>14</sup> For example, see: Levine, Michael E., "Price Discrimination Without Market Power" (June 2001). Harvard Law School, Law-Econ Discussion Paper No. 276. <http://ssrn.com/abstract=224947>.



demand that will lead to an increase in market price, all else equal, and vice versa for decreases in IATA fares. This suggests that the relationship depicted in the simple ‘capacity constrained’ scenario above may be relevant even in the absence of capacity constraints. (However, note that such a demand-based correlation of prices does not necessarily imply an increase in profits, given the existence of many fare classes and the implications of the platform operating in a competitive market. We discuss this issue next.)

Second, the fact that fares are offered on a shared platform operating in a competitive market has potential implications. If the ‘platform market’ (in this case commercial air transport flights) is competitive, then in the long run the industry will exhibit zero economic rents. Under this scenario, an increase in the price of A that causes an increase in the profitability of segment A will eventually result in a decrease in the price of B in order to re-establish the zero profit condition.<sup>15</sup>

This concept was central to the recent investigation in the UK into mobile termination rates, where there was extended discussion of the relationship between the prices to call a mobile subscriber, and the prices the mobile subscriber eventually pays, given that in a competitive market ultimately the two sources of revenue must balance to cover costs. The UK Competition Commission called this the ‘waterbed’ effect. Although there was much debate over this issue, the debate did not turn on whether such an effect was plausible in theory. The theory was not in dispute. Rather, it turned upon whether the regulators believed that the market for mobile subscribers was sufficiently competitive to ensure complete pass through to subscriber prices of changes in termination rates, and over what time period such an adjustment might occur.

The waterbed effect is in practice a reverse coat-hanger effect. The implication for airline ticket prices is that, were IATA fully flexible interline fares raised to an excessive level, this would not result in rents accruing to industry participants. Assuming full competition, higher margins on some fares would lead to lower ticket prices in other fare categories, which would then bear a lower mark-up over variable costs. Following the discussion above of the potential interactions between prices of IATA flexible fares and demand for business fares, it is not clear whether the downwards adjustment would occur in business class fares. It might well be in economy fares. However, the implication is that it is likely that in the long run there would be a negative correlation between the price of one fare class and one or more others, if such an increase led to excessive profitability.<sup>16</sup>

This effect would be very difficult to identify empirically, given the constant short-run pricing changes in the market and the various shocks that buffet the aviation market. Nonetheless, this

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<sup>15</sup> This note discusses the issue in terms of two product segments, however the analysis is general and readily extends to  $n$  product segments. Even in the simple case of cinema ticket pricing it is normal to have more than two prices on the published price menu.

<sup>16</sup> There can be little doubt that the airline industry in aggregate is a highly competitive business. Mr. Giovanni Bisignani, director-general of the International Air Transport Association (IATA) forecast a \$2.4 billion profit for the industry worldwide in 2004, after losses totalling \$30 billion since 2000. *Silver linings, darkening clouds*, The Economist, Mar 25th 2004.



does not undermine the importance of the general insight that it is entirely plausible for a theoretical relationship that is directly opposite to the DG Competition's coat-hanger effect to hold.

### *Productive Efficiency*

The Consultation paper also makes the point in paragraph 18 (see below) that the IATA tariff conference system may lead to productive inefficiencies, leading to increased costs which are passed on to consumers.

*18. Finally, inherent to the IATA interlining system are the agreed mileage rules (See above paragraph 12, 4th bullet point). These rules provide passengers, subject to the conditions governing their initial reservation, with significant flexibility in terms of changing routes (subject to certain distance limits) and adding or deleting intermediate stopping points. Where passengers would make use of this flexibility, it is possible that the overall costs incurred by the airlines should be higher than those that would be incurred in the case of a more or less standard and straightforward journey. These cost related uncertainties appear to have some inflationary effect on the level of fares agreed in the IATA passenger tariff conferences in so far as, where carriers agree on an interlinable fare for a given segment, they have to take into consideration the possibility that passengers may split the segment(s) in question in two or more segments, which would likely result in higher overall operational costs for the airline community.*

The above paragraph suggests that the flexibility of IATA tickets may lead to increased costs in the industry in various ways. Assuming this assertion is correct,<sup>17</sup> we note that from an economic perspective higher costs associated with the production of a superior product should not be classified as a social detriment. As long as the cost of production is the minimum practical for the given quality level and consumers willingness to pay for that product is greater than or equal to the cost of production, then that production is socially efficient. Whether the quality (and therefore cost) of the product is at the appropriate level is a matter for consumers to decide. This logic also applies to the argument that IATA fares allowing shorter segments to be combined, with shorter segments being more costly on a passenger kilometre basis, is somehow inefficient.<sup>18</sup>

### *Summary*

There is no general theoretical support for the idea that two differentiated products must be priced at a necessary price differential from each other given product quality differences. For

<sup>17</sup> It is not at all obvious that this argument is correct. IATA fares have features that could suggest production costs would be increased, such as added flexibility, but other features that reduce costs, such as improved integration across airline networks. It is not obvious that the net result is higher system costs overall.

<sup>18</sup> This is akin to suggesting that choosing to take a taxi home from the airport late at night is less efficient than taking a train and then walking. This might be so, in terms of the cost of production, but no one would suggest such a decision by a consumer is socially inefficient as a matter of market economics.



partial substitute products there are competitive interactions with—depending upon the circumstances—changes in the price of one will change the price, volume or both of the other product. However, this effect is the result of the interaction of supply and demand. It does not represent some simple fixed value relationship between the two products, nor does it indicate some form of anticompetitive outcome, or market distortion. In summary, the analysis demonstrates that:

- If the markets for differentiated good A and B are competitive, then both products will be priced at cost. The number of consumers that buy each will be determined by price/product features combined with the distribution of consumer preferences.
- If only one of the markets (say market B) is competitive and exhibits no capacity constraints, its pricing will still be set by production costs. The price of A will impact the volume, but not the price, of sales of B.
- If the market for B is capacity constrained, then changes in the price of A will affect the price of B. This will generate a positive correlation between the price of A and B, but only because of the competitive implications of changes in demand for B, not because the price of B needs to maintain some fixed relativity to the price of A. Intermediate cases would result in intermediate outcomes (some change in price, some change in volume).
- Removing product A from the market will have no impact on the price of B absent capacity constraints, but with capacity constraints it will *increase* the price of B.
- Joint production will lead to demand-based market pricing. This means there is the potential for a positive demand-based correlation of the prices of A and B, in the extreme as depicted in the capacity-constrained case, but in the absence of such constraints.
- Joint production also introduces the potential for a waterbed effect. This is a reverse coat-hanger effect, which requires that the total value of all production from a shared platform in a competitive market must sum to the cost of the platform. If the price of one product produced on the platform is set at excessive levels, it will lead to falls in the price of one or more of the other products produced on the platform.
- Any increase in costs due to the IATA tariff system will be to enable airlines to supply customers with a superior IATA product, which cannot be classified as a deterrent to consumer welfare.

In modern airline markets, there is a proliferation of airline fares types supported to various degrees by restrictions on changing route and carrier, amongst other booking restrictions. Analysing IATA and flexible business class fares in isolation from other fare classes will miss the economic complexity of how competition operates in practice – see the section on how airlines price.



In short, the proposition that “the unavoidable consideration” of IATA fares by airlines must lead to *coordinated effects* in the setting of airline specific fares is not supported by economic theory.



## INFORMATION EXCHANGE

The Consultation Paper refers in paragraph 44 to IATA providing a forum in which airlines discuss prices, costs and general airline information that can only reinforce the alleged restrictive effect of product differentiation.

We note that the Consultation Paper has not specified in paragraph 44 whether the relationship of interest is between IATA tariffs and economy and/or business fares. We assume that the Consultation Paper is taking a similar line to its 2001 consultation and focussing on carrier's business class fares which are the nearest substitute for the IATA fully flexible ticket and we will focus on this relationship in this section. We do not believe that, given the proliferation of economy class fares, lack of capacity restrictions and intense competition from low-cost carriers, it is credible to suggest that IATA processes could provide a forum for co-ordinating economy fares.<sup>19</sup> However, we should note that the theory alluded to earlier could suggest that any effect of the IATA process might be seen on all carrier fares (and restrictions). If we do not see any link between the most flexible business class fare and the IATA process, we would expect that this (lack of a link) extends to all other fare classes.

To analyse the impact of IATA as a forum we first need to clarify the competition problem. The Consultation Paper is implying they don't imply this – they state it that IATA provides a forum where airlines exchange information on costs, prices and general economic information. This implies that airlines could use this information to reach, a common understanding on how to set their own carrier-specific fares. In other words the information exchange would facilitate either tacit or explicit collusion. To assess this argument, it is necessary to consider whether the information that is actually exchanged at IATA tariff conferences is such that it could be viewed as having this effect.

For the analysis of the potential for information exchange to facilitate collusion in airline markets, three aspects are of particular significance:

1. Collusion represents a deviation from firms' short-term profit-maximising strategy. Hence, given the behaviour of its rivals, each firm has an incentive to undercut its competitors.
2. From (1) it follows that collusion can only be maintained if the long-term profits from collusion for each firm are higher than the profits from deviating from the collusive price level, which would be followed by 'punishment' by the other firms.
3. The incentive to cheat on the other firms is larger if the market conditions do not allow firms to observe if their competitors deviate from the collusive behaviour. In such non-transparent markets, collusion usually cannot be maintained.

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<sup>19</sup> On this, we note that some of the most aggressive low-cost carriers, such as Ryanair and easyJet choose not to participate in IATA.



It follows that information exchange may help collusion if it:

- (A) Facilitates a common understanding on the terms of coordination.
- (B) Helps the coordinating firms in monitoring whether the terms of coordination are being followed.
- (C) Improves the ability or reduces the cost of punishing a deviator.

Note that for collusion to occur, all elements (agreement, monitoring, punishment) must be fulfilled. The three elements are necessary but not sufficient conditions for collusion. We discuss each point in turn.

### *Facilitation of coordination*

This concern refers to the exchange of information that might assist in facilitating agreement on the objective and terms of coordination.

A fundamental requirement for coordination of any type is clear agreement on what is being coordinated. This is easiest when there is only one relevant market (and it is clear to all where the market boundaries lie), and a single relevant price point. However, with many markets, customer segments and prices, establishing agreement on who is cooperating on what is a complex problem. Relevant examples of information exchange that could help with establishing agreement on what is being coordinated include information on geographic markets one intends to cover, planned sales, future prices and the capacities one intends to build or employ.

Thus, in general, information exchange that concerns *future* plans regarding prices, sales, and capacities for individual operators could be used to facilitate coordination. More general information about future demand or cost conditions seems to be of less importance unless it is combined with information about prices, sales and capacities of individual firms or allows others to infer that information.

Information on the present or the recent past may in some circumstances also help coordination. If for example a market leader regularly publishes prices, whether list prices or historical actual prices received, this may serve as the focal point for the colluding firms to follow.

One way to address concerns about the improved ability to coordinate through collective information exchange is to aggregate (anonymise) the data. If individual operator action or intentions cannot be inferred from the data, the ability to reach an agreement will usually be significantly impaired.<sup>20</sup>

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<sup>20</sup> However, Genesove and Mullin (2001) also point out that anonymising data may increase the incentive for firms to participate.

**Table 2: Information exchange that may facilitate coordination**

Category	Type and Characteristic of Information Exchange
Type	Prices, sales, capacities
Time period	Future, recent past
Aggregation	Disaggregated (individualised)
Availability	Private and public

Source: CRA

### *Detection of cheating*

This concern refers to the exchange of information on *past* behaviour, which in turn may facilitate successful detection of cheating.

If collusion is successful in the short term, each individual colluding party has an incentive to undercut and free-ride on the high price charged by the others. One of the most difficult problems for the colluding parties is to detect any such secret price cuts or sales that are the additional to the collusive quantities or quotas agreed. Information exchange may be used to agree on rules, which facilitate the detection of “cheating”. For example, firms can communicate about business practices and agree that all firms publish their prices and do not give discounts. This coordination would facilitate the critical monitoring function.<sup>21</sup>

Information about prices charged and quantities supplied by the colluding firms in the past is essential for monitoring deviations. Exchange of general information on cost, capacity and aggregate demand data for previous periods is likely to be much less useful for detecting deviations from the collective agreement. Indeed, there are considerable benefits to sharing such general information, as knowledge of market conditions is important to allow firms to understand changes in the market and plan for the future effectively.<sup>22</sup> Trade associations and consultancy firms that do benchmarking studies commonly provide this kind of information.

Another important requirement is that cheating can be detected sufficiently quickly and accurately that the expected gains from cheating are limited to being less than the expected costs. Thus, revealing prices that refer to the distant past may not be particularly useful. The specific critical time period depends on the frequency of sales, the margins on the product, the likely cost of detection (punishment) and the time horizon of the industry managers.

<sup>21</sup> See Genesove and Mullin (2001) for a detailed description for how communication may help coordinating and resolving the monitoring problem.

<sup>22</sup> In economic theory one of the common explanations of sub-optimal outcomes is imperfect or asymmetric information. From this perspective, information dissemination is generally pro-competitive.



This analysis shows that competition concerns can be effectively addressed by aggregating (anonymising) the data. If this method is effective, individual operators can cheat under the shelter of total demand.

**Table 3: Information exchange that may help detect cheating**

Category	Type and Characteristic of Information Exchange
<b>Type</b>	Prices, sales
<b>Time period</b>	(Recent) past or present
<b>Aggregation</b>	Disaggregated (individualised)
<b>Availability</b>	Private and public

*Source: CRA*

*Ability to punish and cost of punishment*

Information exchange about future and past prices and quantities may affect the ability and the cost of punishment. For example, if in a scheduled transport service collusion builds on a market sharing agreement, the announcement of a new schedule that would not be in line with the collusive arrangement could trigger a punishment response even before market entry (e.g. a price cut), this can make punishment very effective and therefore help stabilise a collusive arrangement. Information exchange may also help targeting the punishment schemes. In localised markets it might be possible to target punishment against the cheating party if sufficient information exists to determine who has cheated. This reduces the cost of punishing a “cheater” and so makes the threat of punishment more credible.

Airline markets are typical of transport services as it is not possible to avoid publication of schedules and at least some tariff data. However, where individual contracts are made (e.g. corporate deals for business class fares or more direct distribution strategies etc.) the possibility of anti-competitive effects is substantially reduced. The arguments regarding the publication of information and the effect on punishment are the same as with regard to the role of public versus private information in the agreement of collusion and detection of cheating. The key point to investigate is whether public information would facilitate the information transmission, which would otherwise be prohibitively costly.



*Evaluation of potential for tacit collusion on business class fares and role of IATA*

The economics of whether information exchange within IATA facilitates collusion depends on whether the market for business travel is susceptible to tacit collusion and then, and only then, whether the IATA forum *adds* any disaggregated information necessary (and which could not be obtained by airlines unilaterally) for airlines to use it for collusive purposes.

We set out the general theory above. This has been followed in the Court of First Instance judgement in *Airtours*<sup>23</sup> and is now summarised in the Commission's Notice on assessment of Horizontal Mergers. The most important factor is the nature of the product and the circumstances in which it is sold. Business travel is a differentiated good sold on non-price attributes such as convenience, frequency of service and more marginal features such as frequent flyer schemes as well as price. This makes it an unlikely product *per se* for tacit price collusion.

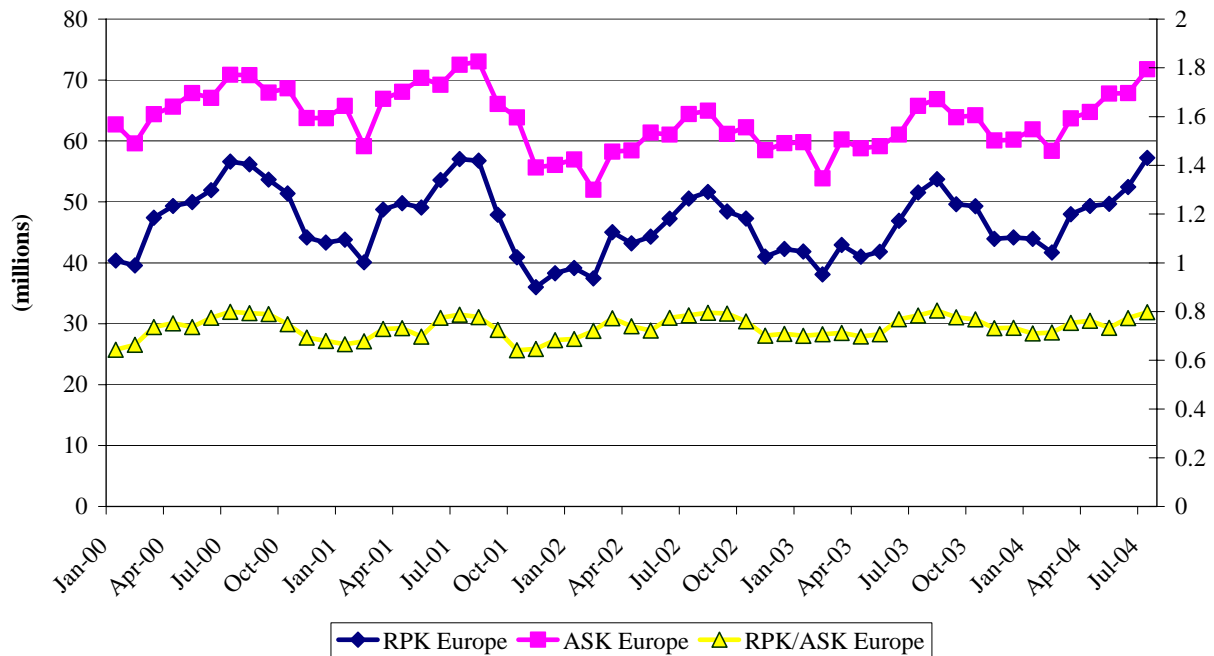
Airline pricing appears on the surface to be extremely transparent. Modern CRS systems mean that airlines know the range of published fares that are being offered by their competitors at all times. However this transparency may be deceptive and hence published fares may be less informative than they appear for three reasons. First, all airlines operate with a range of fares; their load management systems then restrict or increase the availability of the cheaper fares depending on capacity and demand. We have already noted earlier the proliferation of fares and restrictions in modern airline pricing. Second, large companies obtain unpublished discount fares through airline corporate programs that are an important feature of carrier marketing. Corporate programs have increased in scope and number. Hence two airlines with the same published fares could at a specific time offer very different prices. Third, the nature of distribution is changing as airlines sell more tickets direct to the customer either through corporate deals and/or on the Internet.

Airlines compete fiercely for the business passenger. In competing for the passenger on a particular route, a key competitive strategy is to increase capacity through increased frequencies, as service quality is a key service attribute valued by business travellers. The very process of increasing capacity in turn increases price pressures as the competitors attempt both to increase their share of the market and to grow overall demand in order to sustain the higher frequency and associated capacity. Transport industries tend to exhibit this pattern, which combined with short-run marginal costs significantly below average costs, tends to lead to intense pressures to both increase capacity and compete for a larger share of the market. This intense pressure to 'cheat' and compete with and for quantities (passengers) makes price collusion very difficult to sustain.<sup>24</sup> We believe that this is reflected in the data in Figure 4 below, which shows that capacity adjusts relatively quickly and fully to accommodate demand shifts within Europe.

<sup>23</sup> Court of First Instance Judgment Case T342/99 *Airtours* 6 June 2002

<sup>24</sup> Indeed, it is notable that transport markets, such as aviation and bus transport, are more commonly associated with allegations of predation as an anticompetitive behavioural problem rather than collusion.

Figure 4: Passenger seat kilometres: available versus actual - Europe



Source: IATA statistics.

In conclusion, business travel is a differentiated good sold primarily on non-price attributes and together with the inherent incentives to increase capacity (frequency / size of aircraft) this makes it an unlikely product for tacit price collusion. While airline fare ranges are transparent, both unpublished discounts and airline load management systems affect actual day-to-day effective fare levels. The effects of individual fare adjustments are complex and this would make collusion even more difficult.

IATA Tariff Conferences as a Facilitator for Tacit Collusion

Business travel *per se* is an unlikely product to be subject to tacit price co-operation. However even if it were subject to such co-operation, it is far from clear that IATA and/or the IATA tariff conferences would be an important factor facilitating such co-operation as demonstrated below.

IATA

IATA collects and publishes airline statistics. IATA collects from the airlines on a monthly basis:



- Traffic and Capacity data (Revenue Passenger Kilometres, Available Seat Kilometres, Passenger Load Factor, Freight Tonne Kilometres, Available Tonne Kilometres) per airline and per route. This information is public and IATA collects it directly from various sources including airline's web sites. This data is used in their monthly international traffic statistics and is used in IATA's press releases. The data is also consolidated and sold through reports such as "Carrier Tracker".
- Passenger, freight and mail volume per airline per flight leg. This information is also submitted by the airlines to the various Regional Airline Associations such as AEA, and to the DOT for the US carriers. This data is consolidated per region and sold in reports such as "Route Tracker" with a 2-month delay.

On a yearly basis IATA collects:

- Key operational performance indicators per airline such as traffic, capacity, fleet size, number of employees, etc. from the Annual Reports of airlines. It is published annually in IATA's "World Air Transport Statistics" publication.
- Traffic forecasts from airlines are consolidated and published in biannual forecast publications.

Due to the inherent perishability of the product in question, the statistics collected are historic in nature and are also aggregated to ensure that individual airline strategies cannot be discerned and/or can be responded to using the information provided. None of the statistics impact directly on pricing or capacity decisions made by individual airlines.

### IATA Tariff Conferences

IATA conferences are concerned with much more than setting published interlinable fares and rates. They are at the core of the essential common standards and systems for reservations, tickets, air waybills, passenger and cargo handling, baggage, data transfer and communication protocols that make multilateral interlining possible and efficient. IATA tariffs are set in discussions taking account of market-level factors influencing airline travel, such as the cost of kerosene, airport charges and landing fees, and capital investment costs for aircraft. Airlines propose the level of IATA published fares and rates based on this discussion. Every airline has a veto on these proposals. There is no discussion of airline on-line prices or capacity. Representatives of regulatory authorities, including the Commission, may attend these conferences, and have done so.

The Consultation Paper (paragraph 44) suggests that IATA discussions enable airlines to get a detailed insight into the thinking behind competitors' pricing strategies. But in fact most of this information is routinely available. All airline published fares are available to competitors through the CRS systems.



Published fares for a particular ticket tend to be similar and to move together. The co-movement of airline on-line published fares is a feature in both the US and EEA. But this does not depend on IATA as there is no IATA interlining in US domestic airline markets. Automated systems used by the industry are a much more timely information source than tariff conferences which normally meet once a year for passenger and once every other year for cargo.

The important variable costs in this industry are well known to everyone. The price development of inputs such as kerosene, airport charges capital investment costs and even airline salaries are publicly available. Aircraft purchases and deliveries are widely reported. It is unclear how IATA conferences could make airline fares or costs more transparent.

### *Summary*

If effective collusion was to occur, the key variables that would require agreement are capacity and how capacity is allocated, and the *effective* market price a passenger pays for carrier business fares.

CRA has reviewed the minutes of passenger and cargo tariff conferences meetings for intra-EEA and outside EEA and for the cargo conference meetings for routes out of the EEA. We have seen no evidence to suggest that these issues – which go to the heart of competition between airlines – are discussed at these meetings or that any inference can be made from the discussion as to individual price strategies of particular airlines.

The Consultation Paper agrees that a requirement for interlining exists and that by satisfying this requirement for interlining IATA generates consumer benefits. It admits that without IATA the requirement would still exist. Any alternative would likely encourage further bilateral or alliance agreements on specific routes or regions. This raises the obvious concern that such large scale ad hoc negotiations would give rise to even more opportunities for explicit or tacit collusion than the present controlled conference system, for it is more likely that bilateral discussions could turn to issues of capacity on a particular route.

In summary, a great deal of information about airline costs is public and competing published fares are immediately available through the CRS systems. However, both the nature of the carrier product and the way in which it is sold means that it is difficult to see how this market is open to tacit collusion. Moreover, it is difficult to understand how IATA as a body which disseminates statistics and/or IATA tariff discussions adds much to any transparency. If the present system of conferences were to end, the general bilateral or multilateral negotiations that would be required to replace them could well give rise to much more serious opportunities for tacit or explicit collusion.





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## APPLICATION TO CARGO MARKETS

DG Competition suggests in its consultation that competition from operators such as Federal Express, UPS and DHL mean that the IATA system of cargo interlining is not needed. We consider that there are two views of the relationship between IATA member airlines offering cargo services on a multilateral interline basis and such dedicated freight operators that DG Competition might need to take into account. The first is a view that these operators operate independently to the IATA system. The second is if such operators are considered to operate at least partially within the IATA system.

If, as appears the case from the consultation document, DG Competition takes the view that operators such as Fedex, UPS and DHL are effectively able to operate independent competitive networks to that the IATA multilateral interline system, then in general this would significantly *reduce* the potential for any anticompetitive effects from multilateral interlining. As a general rule, increasing the number of independent competitors reduces the potential for anticompetitive effects as any competitor co-operation is less likely to result in market power being achieved either due to the reduction in competition between the two partners, or because the reduction of the number of competitors facilitates tacit collusion. This is why co-operation between competitors with minimal market shares is normally not considered likely to result in a substantial lessening of competition. From this perspective, to the extent that these operators are considered to be independent operators, they should reduce the likelihood of any competition concerns.

The above view is supported by the observation that these operators offer significant coverage using their own aircraft. UPS Air Cargo for example advertises that it UPS Air Cargo provides ‘fast, reliable, airport-to-airport cargo service to over 100 U.S. Airports and over 111 International Airports’.<sup>25</sup>

Another view is that these operators are at least partially dependent upon the IATA system, and hence it might be argued do not offer a competitive constraint to IATA pricing. This view would seem extreme, given the coverage of an operator such as UPS. Nonetheless, 111 airports outside the US is a small proportion of the total number of destination serviced by IATA airlines.<sup>26</sup> Indeed, we understand from IATA that these operators do use the IATA system, both to reach points not covered by their network, and to cover urgent or part shipments that they cannot accommodate within their own network.

However, this does not mean such operators are competitively insignificant, even for the routes they do not operate themselves. As very large customers of IATA member airlines we understand that they enter into confidential contracts at very favourable rates with existing

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<sup>25</sup> <http://aircargo.ups.com>.

<sup>26</sup> According to IATA, scheduled services operate to 488 airports in the EEA alone.



operators. This means that they can potentially offer competitive prices for routes outside of those directly operated by their own aircraft, and offer more competitive constraint than their own (not insignificant) networks might suggest. Further, to the extent that such operators utilise the IATA multilateral interline system themselves, it suggests that no cheaper option exists to deal such shipments. If there were, such operators would be in the business of finding cheaper options (such as various agent arrangements).

#### *Possibility for tacit collusion in cargo markets*

CRA notes that the Consultation Paper does not consider separately the issue of restrictive effects in cargo. However, we have seen a copy of DG Competition's cargo Statement of Objections which does proceed on a simplistic coat-hanger theory

This theory is even less plausible for cargo than for passenger (and as can be seen from the empirical section later not evidenced by the data). Amongst the factors that suggest tacit collusion is difficult in these cargo markets we note that:

- A relatively small number of forwarders, consolidators, and major industrial shippers account for most air cargo shipments.
- These major customers negotiate special rates specific to themselves – these rates are not transparent to other suppliers.
- Two participants in the cargo conferences are also major purchasers of the interline product and as demonstrated above, they will have different objectives to the general airline operators.
- Since route-specific constraints do not restrain air cargo competition (cargo does not mind circuitous routings) major cargo operators and niche operators can offer alternatives for a large proportion of shipments.
- Most air cargo is flown in the belly of passenger aircraft – so capacity is set by reference to factors external to the air cargo market, and it does not vary with changes in demand, making pricing more volatile.
- Where IATA rates are charged they are often subject to a substantial discount in the portion retained by the selling carrier – the real role of the industry rate is to set the prorate for the accepting carriers.
- Information exchange at cargo conferences is less extensive than at passenger conferences and even less likely to facilitate collusion due to the even fewer meetings of the members. If the concern in the Consultation paper is that “airlines meet” it is hard to conceive that two meetings of the cargo conferences from 2001 to 2004 have orchestrated



(tacit) collusion between the operators.

### *Summary*

If the views in the Consultation Paper are accepted, then the IATA system in effect provides an additional competitive network to that of large cargo operators such as UPS, with the addition of connecting services that would otherwise not readily be available. This must be a pro-competitive situation. If the networks are not seen as being competitors in this fashion, then the presence of these operators as significant and sophisticated buyers of freight capacity if anything increases competition in the cargo market. In either case, there is no clear connection between the existence of these operators and a view that the IATA system is no longer needed or justified.

We established earlier that tacit collusion is difficult in passenger markets. In the case of cargo, we consider it even more difficult to establish such tacit collusion and the IATA tariff setting process does not provide a framework for establishing it.



## **EMPIRICAL EVALUATION OF THE COMPETITION CONCERNS IN THE CONSULTATION PAPER**

In order to validate the concerns expressed in the Consultation Paper should ideally have included data and analysis backing up the theoretical arguments set out in paragraphs 43 and 44. In the absence of such empirical evidence, we outline some potentially interesting data which, *prima facie*, does not support the case against both the passenger and cargo tariff conferences set out in the Consultation Paper.

### *Fundamental flaw in correlation analysis*

To prove the assertions in the Consultation Paper one would need to find a casual link between the setting of IATA fares and a carrier's business class fares. There are two fundamental difficulties with attempting an analysis of the link between IATA tariff setting and carrier on-line business fares. First, is the elementary statistical fact that correlation does not imply causation. A correlation may imply that IATA fares influence carrier's business class fares or vice-versa. Second, common influences are likely to cause the IATA and business class fare to move together. Indeed, as the two fares are "produced" on the same platform this is virtually certain to be the case. These common influences come on both the demand and supply side. On the cost side, both types of fare will be subject to length of route, attributes of the origin and destination, changes in variable costs such as fuel, inflation and other exogenous changes to business costs. On the demand side, changes in the competitive environment may also impact on both on-line fares and interline tariffs, though this may differ more because the nature of the travel may be different (IATA product is different in terms of its flexibility, especially on connecting travel). Commentators<sup>27</sup> have therefore argued that pure correlation analysis provides little basis for evaluating DG Competition's claims.

### *Passenger fares*

If correlation analysis does not provide a sound basis, we may look at the driving force for change in the structure of fares. Starkie and Kain concluded in their paper criticising DG Competition's reports by Aloy and Lévêque<sup>28</sup> that "overall our impression is that, following the

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<sup>27</sup> Starkie, David and Peter Kain (2000) Tariff consultations and the level of carrier-specific fares. Economics-Plus. December 2000.

<sup>28</sup> Aloy, Elise and Lévêque, François (1998a) Assessment of the effects of the promotion by IATA of universal interlining. CERNA. September 1998; and, Aloy, Elise and Lévêque, François (1998b) The effects of tariff consultations on fare levels. CERNA. December 1998

third liberalisation package, competition was a driving force for change in the structure of fares between 1992 and 1997. As a result, on most routes in the database, carriers developed new flexible fare structures that offered the business traveller an effective alternative to the IATA fully-flexible tariff'. This interpretation of the data seems accurate and would be even more the case as competition has increased in airline markets since. For example, the introduction of different distribution strategies to market, the large demand shock post 9/11 and the lower pricing by low-cost carriers (which impacts even on business class fares) would suggest that we may even see less relationship between IATA tariffs and carrier business class fares in 2004 than in previous years.

#### *IATA fares data*

IATA provided CRA with the IATA and the 'next best substitute' fully flexible business class fares for 2001 and 2004 for a number of city-pairs. The data is described in more detail in Annex A. In this section, we summarise the main features of the data. Overall, IATA fares have in nominal terms increased from May 2001 to August 2004 for all routes, with an average increment of 10.3%. Carrier fares display significantly more variability for this period across the different routes, exhibiting both nominal increases and decreases, and an overall nominal increase of 0.7%. Correcting for inflation (CPI), IATA fares shows an average increase of 3.5%, with falls in real terms on 10 routes. Carrier fares dropped in real terms in 29 cases, and averaged a real fall of 5.6%.

In terms of the level of prices, in May 2001 carrier tickets were sold, on average, 19.5% cheaper than IATA tickets. By August 2004 price differentials increased significantly, with carrier tickets being sold on average 26.5% cheaper than IATA tickets. Simple summary statistics show that both the level of price differences between the two fares and the level of variability increased significantly between May 2001 and August 2004.

#### *CARGO*

One of the implicit concerns voiced in the Consultation Paper concerning cargo conferences is that the current IATA cargo tariff setting conference allows airlines to co-ordinate on carrier (i.e. non-IATA) rates. In the current consultation, the Consultation Paper is proposing to prohibit the setting of IATA tariffs between Community airports and third countries. Given the differences between current intra-EU cargo rates setting (no IATA tariff) and to/from EU rates (with IATA tariff), it is possible that the evolution of carrier rates can shed some light on whether DG Competition's concerns in 2001, when the intra-EU cargo conference was prohibited, were justified and in turn on whether the Commission's current concerns are potentially valid.



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*The hypothesis and evidence*

In February 2002 IATA abandoned multilateral cargo rate setting for routes within the EEA, whilst maintaining the cargo conferences for routes out of the EEA to elsewhere in the world. If intra-EEA route tariff setting had in fact created a “coat-hanger” effect on cargo rates, where carrier cargo rates were maintained at a level above the level that would have prevailed absent the intra-EU conference, we might expect to observe two effects following the cessation of the intra-EU conference. First, a significant negative correction in intra-EU prices could have occurred in the period following the cessation of the conference (perhaps over the next six or so months) if any distortion had been significant and market rates subsequently adjusted to the competitive rate. Second, given that it is now possible to conduct a ‘with and without’ comparison between within-EU and extra-EU routes, it might be possible to observe significant differences in pricing behaviour.

*The data*

CRA has been provided with data covering air cargo originating from Belgium, Germany, Spain, Sweden and the UK to 55 destinations around the world, both within and outside the EU. These countries are listed at Annex B. The database gives the monthly number of Air Waybills (AWBs), the total weight shipped, and the revenues generated by these shipments between January 2000 and June 2004. This allows us to calculate an average revenue per kilo shipped by airfreight for each month.

We note that of the total revenue recorded in the sample over this period, 92.4% related to shipments to the rest of the world, while only 7.6% related to air freight shipments within the EEA. This would suggest that, to the extent that IATA cargo interlining produces significant benefits to users of the system, the bulk of these benefits are likely to be associated with shipments to third countries outside of the EEA. Air waybills are also larger on routes to and from the EEA (averaging 705 kg), than within the EEA (averaging 156 kg).<sup>29</sup>

We also note that this data does not give a direct measure of prices or price changes. Cargo tariffs are highly complex, and movements in average revenues per kilo will be driven both by price changes and underlying mix changes (weight, nature of good, type of shipment such as dangerous air cargo, and so on). If it is assumed that mix remains relatively constant over time for large volumes of observations, then revenue per kilo changes will reflect price changes. Given that the data covers large volumes of activity aggregated to country pair level (for example, shipments from Germany to the US), assuming relatively stable mix is probably not unreasonable but this is a key assumption.

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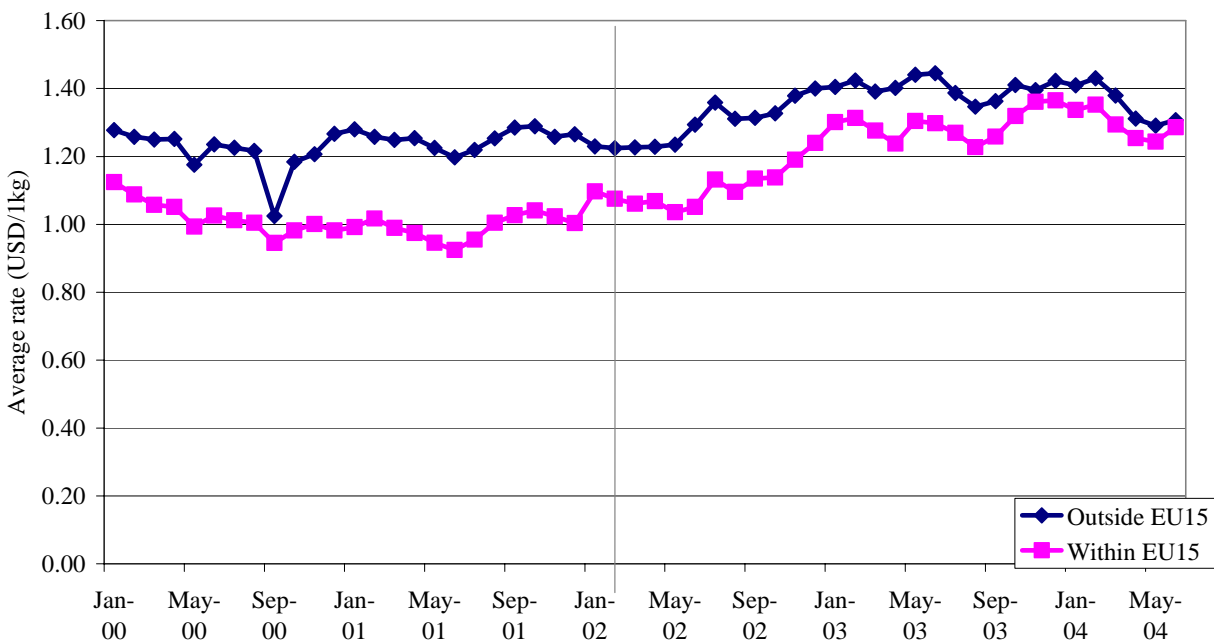
<sup>29</sup> 2004 figures for air waybills.

The evidence

Figure 4 (below) illustrates the evolution of average cargo rates (revenue per kilo) from January 2000 to June 2004. It shows that the rates for shipments terminating within the 15 EU member states have, in relation to rates terminating outside the 15 EU member states, evolved in a manner that appears to be inconsistent with significant anti-competitive effects having resulted from the intra-EU conferences prior to the 2002 withdrawal of IATA intra-EEA rates. If the conferences had an anti-competitive impact, then we might expect to see a fall in the average revenue per kilo for cargo carried within the EU following the 2002 prohibition, all else being equal. However, the average revenue per kilo within the EU has in fact increased steadily, and more rapidly than the average revenue to destinations outside the EU.

This does not provide conclusive evidence that intra-EU cargo rates post February 2002 have not benefited from DG Competition’s decision, and are not lower than might otherwise have been the case. However, it does not suggest a clear shock in the direction that might have been expected in 2002 if DG Competition’s concerns had been justified. Hence it does *not* provide *prima-facie* support for the view that intra-EU cargo conference had significant negative effects on market prices. Further, in our view, we believe the data does provides *prima facie* evidence that the change had no effect.

**Figure 5: Evolution of average carrier revenue per kilo terminating within and outside 15 member states**



Source: IATA, Cargo IS Consolidated Market Report with Revenue.



The results shown should be interpreted with care, as they do not account for changes in the product mix, nor does it allow for other changes in the market. Thus, the price increase between 2002 and 2004 might actually be due to an increase in the relative importance of more expensive shipments, or other changes in the market such as reductions in scheduled passenger activity.





## **Overall Conclusion**

In this paper CRA has reviewed the theoretical arguments in paragraphs 43 and 44 of the Consultation Paper suggesting that the IATA tariff conferences have a restrictive effect on competition. We have concluded that:

- CRA concludes that DG Competition has not made any plausible theoretical or empirical case for concluding that IATA tariff conferences restrict competition.
- Arguing that there is a necessary or fixed relationship between IATA and airline tariffs, based on product quality differences, is unwarranted in theory. Prices and quantities can interact in a number of ways, depending upon capacity constraints and relationships created by the importance of demand in setting market prices, but these effects in no way reflect a restriction of competition. Rather, they are the result of the competitive balance of supply and demand in the market.
- Business travel is not conducive to tacit coordination and cargo is perhaps even more difficult to coordinate. IATA as an institution and the tariff conferences, in particular, provide no basis for facilitation of such coordination, even if it were possible.
- If airlines pricing is based on a competitive common platform any economic rents that accrue must arise from a restriction of competition that operates across *all* rate categories, including all business and economy fares. In other words, it would require a restriction of capacity between carriers in terms of scheduling and the type and operation of aircraft. We have seen no evidence of this and there is no evidence to suggest that the industry is excessively profitable.
- Cargo and passenger pricing is dictated by increasing sophistication of the revenue management systems which take account of seasonal and daily influences on the price of travel for passengers and cargo alike.
- CRA has collected some data which may suggest that there is increased competition in business fares in 2004 compared with 2001, even though tariff setting processes have operated throughout. Moreover, the abolition of the cargo conference tariff-setting for intra EEA routes has not introduced an obvious positive shock effect on cargo rates (that is, a one-off fall in rates), which might have been the case if there was a “coat hanger” effect prior to February 2002.

## **ANNEX A: IATA AND CARRIER FARE DATA 2001 – 2004**

### *Introduction*

The fare data in this annex has been provided to us by IATA. The data looks at the difference between and changes in IATA flexible business fares, and carrier flexible business fares between May 2001 and August 2004. The analysis is based on data captured and presented to the Commission during the previous investigation of interlining arrangements by the Commission in 2001.<sup>30</sup>

Notes on the data:

1. The data show yearly information for 44 city pairs within the EEA. IATA fully flexible fares are shown as at May for the years 2001 to 2004 inclusive, along with the most recent fare available at August 2004. Two observations for the carrier business fares are available for each route. The carrier business fares for May 2001 are those from the previous report submitted in April 2001. These are matched with the most recent fares available in the market as at August 2004. IATA does not hold historical data on these fares.
2. The business fares were chosen by IATA so that fully flexible IATA fares are compared to carrier fares that would meet the needs of the business traveller. Carrier business fares that were not considered included those with differences in price level by season or day-of-week, fees for cancellation or change or those with advance purchase restrictions. Carrier fares might have limited seating (controlled by reservation booking designator), apply only to the fare-owing carrier (or only in combination with specified other carriers), and have limitations on the number of permitted transfers or routing. The fare chosen is the lowest available for the relevant route with maximum carrier/alliance-specific flexibility.
3. The currency units are the same for IATA and carrier fares, and are the currency of the country of origin (i.e. GBP from London, EUR from Paris, Helsinki, and so on).

### *Analysis*

A preliminary data assessment indicates two general results. IATA fares are, in most cases, more expensive than carrier fares – which suggests that passengers are in practice willing to pay a premium for the extra flexibility offered by IATA tickets. The only exception is the Paris-Madrid route, for which both fares are identical.

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<sup>30</sup> The Benefits and Extent of IATA Interlining within the EEA by London Economics. Annex II of Comments of IATA on DG Competition Consultation Paper, 2001. Note that a small number of errors were found in the original data. These have been corrected for this submission, and are noted where appropriate.



Although IATA fares have changed from May 2001 to August 2004, the most significant variations occurred from May 2001 to May 2002. IATA fares have remained fairly stable for the last two years. As business fare observations are limited to two years (2001 and 2004), variability within the time period is not possible to determine.

IATA fares, in nominal terms, have increased from May 2001 to August 2004 for all routes, with an average increment of 10.3%. The minimal increment was 3.0% in the Oslo-Copenhagen route while the maximum rise (27.9%) was observed in the Vienna-Brussels route.

Carrier fares, however, have been much more variable for this period across the different routes. Indeed, nominal fares reduced in 17 cases. The largest fall occurred in the Oslo-Copenhagen route (46.1%). In contrast, the Milan-Paris route observed the largest nominal fare increase at 29.2%. Carrier business fares increased on average just 0.7%.

Further analyses adjusting the data for inflation within each country according to the Consumer Price Index were also carried out.<sup>31</sup> As one would expect, fare increments were less drastic in this case. Moreover, although on average IATA fares increased by 3.5% in real terms, they fell in real terms on a number of routes.

Real carrier fares dropped in 29 cases and on average dropped by 5.6%.

### *Conclusion*

Between 2001 and in 2004 IATA fares have increased slightly in real terms, while carrier fares have fallen slightly, also in real terms. As a result the difference between the two sets of fares has increased on average.

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<sup>31</sup> The inflation rate of the nation of the originating airport was used, as the fares are in the currency of point of origination.

**Table A1: IATA fares and fully flexible carrier business class fares (nominal terms) May 2001-August 2004 for 5 major origin cities**

		CCY	IATA Business Fares					Carrier Business Fares	
			May-01	May-02	May-03	May-04	Aug-04	May-01	Aug-04
<b>To Brussels from:</b>	Amsterdam	EUR	322	360	360	360	360	264	309
	Copenhagen	DKK	7610	8080	8080	8080	8080	6,570	5500
	Lisbon	EUR	1479	1633	1733	1733	1733	1,250	1381
	London	GBP	477	501	524	524	524	346	444
	Milan	EUR	991	1041	1090	1090	1118	788	851
	Madrid	EUR	1305	1428	1538	1538	1585		1481
	Oslo	NOK	10825	11485	11485	11485	11485	8,590	7990
	Stockholm	SEK	13860	14710	14710	14710	14710	9,980	7750
	Vienna	EUR	1195	1358	1528	1528	1528	949	790
<b>To Paris From:</b>	Amsterdam	EUR	612	683	683	683	683	451	474
	Helsinki	EUR	1711	1816	1816	1816	1816	1,180	1,289
	Lisbon	EUR	1337	1433	1506	1506	1506	1,118	1,198
	London	GBP	468	491	513	513	513	399	406
	Madrid	EUR	1161	1219	1244	1244	1282	900	828
	Milan	EUR	844	877	920	932	956	730	943
	Oslo	NOK	11490	12075	12075	12075	12075	9,490	9,380
	Stockholm	SEK	13570	14260	14260	14260	14260	11,340	11,390
	Vienna	EUR	1208	1208	1308	1308	1308	999	1,110
<b>To Madrid from:</b>	Amsterdam	EUR	1,314	1,466	1,466	1,466	1,466	1,035	1,072
	Copenhagen	DKK	11,115	11,450	11,450	11,450	11,450	9,200	6,600
	Lisbon	EUR	571	619	638	647	647	495	581
	London	GBP	540	610	656	669	669	524	629
	Milan	EUR	1,146	1,182	1,222	1,242	1,274	1,112	1,118
	Oslo	NOK	14,090	14,515	14,515	14,515	14,515	10,190	10,790
	Paris	EUR	1,058	1,095	1,174	1,198	1,228	1,037	1,228
	Stockholm	SEK	15,575	16,200	16,200	16,200	16,200	12,090	10,000
	Vienna	EUR	1,663	1,752	1,887	1,887	1,887	1,013	970
<b>To Copenhagen from:</b>	Amsterdam	EUR	869	970	970	970	970	617	540
	Helsinki	EUR	1,087	1,154	1,154	1,154	1,154	911	760
	Lisbon	EUR	1,696	1,835	1,835	1,835	1,835	1,125	949
	London	GBP	590	664	694	694	694	515	591
	Madrid	EUR	1,591	1,671	1,671	1,671	1,671	1,297	1,389
	Milan	EUR	1,179	1,252	1,268	1,268	1,268	931	958
	Oslo	NOK	5,825	6,245	6,000	6,000	6,000	5,190	2,800
	Paris	EUR	1,077	1,114	1,148	1,148	1,177	916	1,049
	Vienna	EUR	1,168	1,279	1,371	1,371	1,371	854	1,010
<b>To London from:</b>	Amsterdam	EUR	518	544	561	561	561	375	390
	Copenhagen	DKK	6,965	7,315	7,315	7,315	7,315	5,595	4,290
	Lisbon	EUR	1,238	1,340	1,381	1,381	1,381	1,024	1,154
	Milan	EUR	892	1,003	1,019	1,019	1,019	780	776
	Oslo	NOK	8,695	9,410	9,410	9,410	9,410	6,690	6,690
	Paris	EUR	558	585	628	628	644	500	524
	Stockholm	SEK	10,155	10,665	10,665	10,665	10,665	8,395	7,860
	Vienna	EUR	1,247	1,298	1,363	1,363	1,363	785	769

**Table A2: Comparison of change in IATA fares and fully flexible carrier business class fares (nominal terms) May 2001-August 2004 for 5 major origin cities**

		Change May 01 - Aug 04	
		IATA Business Fares	Carrier Business Fares
<b>To Brussels from:</b>	Amsterdam	11.8%	17.0%
	Copenhagen	6.2%	-16.3%
	Lisbon	17.2%	10.5%
	London	9.9%	28.3%
	Milan	12.8%	8.0%
	Oslo	6.1%	-7.0%
	Stockholm	6.1%	-22.3%
	Vienna	27.9%	-16.8%
<b>To Paris From:</b>	Amsterdam	11.6%	5.1%
	Helsinki	6.1%	9.2%
	Lisbon	12.6%	7.2%
	London	9.6%	1.8%
	Madrid	10.4%	-8.0%
	Milan	13.3%	29.2%
	Oslo	5.1%	-1.2%
	Stockholm	5.1%	0.4%
	Vienna	8.3%	11.1%
<b>To Madrid from:</b>	Amsterdam	11.6%	3.6%
	Copenhagen	3.0%	-28.3%
	Lisbon	13.3%	17.4%
	London	23.9%	20.0%
	Milan	11.2%	0.5%
	Oslo	3.0%	5.9%
	Paris	16.1%	18.4%
	Stockholm	4.0%	-17.3%
	Vienna	13.5%	-4.2%
<b>To Copenhagen from:</b>	Amsterdam	11.6%	-12.5%
	Helsinki	6.2%	-16.6%
	Lisbon	8.2%	-15.6%
	London	17.6%	14.8%
	Madrid	5.0%	7.1%
	Milan	7.5%	2.9%
	Oslo	3.0%	-46.1%
	Paris	9.3%	14.5%
	Vienna	17.4%	18.3%
<b>To London from:</b>	Amsterdam	8.3%	4.0%
	Copenhagen	5.0%	-23.3%
	Lisbon	11.6%	12.7%
	Milan	14.2%	-0.5%
	Oslo	8.2%	0.0%
	Paris	15.4%	4.8%
	Stockholm	5.0%	-6.4%
	Vienna	9.3%	-2.0%
<b>Summary Statistics:</b>	Mean	10.3%	0.7%
	Std Dev	5.4%	15.6%
	Range	24.9%	75.2%
	Minimum	3.0%	-46.1%
	Maximum	27.9%	29.2%

**Table A3: Comparison of change in IATA fares and fully flexible carrier business class fares (real terms) May 2001-August 2004 for 5 major origin cities**

		Change May 01 - Aug 04	
		IATA Business Fares	Carrier Business Fares
<b>To Brussels from:</b>	Amsterdam	3.8%	8.7%
	Copenhagen	-0.5%	-21.6%
	Lisbon	6.8%	0.7%
	London	5.0%	22.6%
	Milan	4.1%	-0.3%
	Oslo	1.2%	-11.3%
	Stockholm	1.0%	-26.1%
	Vienna	22.3%	-20.4%
<b>To Paris From:</b>	Amsterdam	3.6%	-2.4%
	Helsinki	1.8%	4.8%
	Lisbon	2.7%	-2.3%
	London	4.7%	-2.8%
	Madrid	0.4%	-16.3%
	Milan	4.5%	19.2%
	Oslo	0.2%	-5.8%
	Stockholm	0.0%	-4.4%
Vienna	3.6%	6.3%	
<b>To Madrid from:</b>	Amsterdam	3.6%	-3.8%
	Copenhagen	-3.5%	-32.8%
	Lisbon	3.3%	7.0%
	London	18.4%	14.7%
	Milan	2.6%	-7.2%
	Oslo	-1.8%	1.0%
	Paris	9.0%	11.2%
	Stockholm	-1.0%	-21.3%
Vienna	8.5%	-8.4%	
<b>To Copenhagen from:</b>	Amsterdam	3.7%	-18.7%
	Helsinki	1.8%	-20.0%
	Lisbon	-1.4%	-23.1%
	London	12.4%	9.7%
	Madrid	-4.5%	-2.6%
	Milan	-0.7%	-5.0%
	Oslo	-1.8%	-48.6%
	Paris	2.6%	7.6%
Vienna	12.3%	13.1%	
<b>To London from:</b>	Amsterdam	0.6%	-3.4%
	Copenhagen	-1.6%	-28.2%
	Lisbon	1.7%	2.7%
	Milan	5.4%	-8.2%
	Oslo	3.2%	-4.6%
	Paris	8.4%	-1.6%
	Stockholm	-0.1%	-10.9%
	Vienna	4.6%	-6.3%
<b>Summary Statistics:</b>	Mean	3.5%	-5.6%
	Std Dev	5.3%	14.5%
	Range	26.8%	71.2%
	Minimum	-4.5%	-48.6%
	Maximum	22.3%	22.6%



**ANNEX B: DESTINATIONS LISTED IN DATA SAMPLE**

Andorra	Germany	Latvia	Portugal
Australia	Greece	Liechtenstein	Reunion (FR)
Austria	Greenland	Lithuania	Saudi Arabia
Belgium	Guadeloupe	Luxembourg	Slovakia
Chinese Taipei	Hong Kong	Malaysia	Slovenia
Cyprus	Hungary	Malta	Spain and Canary Islands
Czech Republic	Iceland	Martinique	Sweden
Denmark	India	Monaco	Switzerland
Egypt	Indonesia	Netherlands	Syrian Arab Republic
Estonia	Ireland	Norway	Thailand
Faroe Islands	Israel	Pakistan	United Arab Emirates
Finland	Italy	PR of China	United Kingdom
France	Japan	Philippines	USA
French Guiana	Korea, Republic of	Poland	



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**ANNEX V**

**COMMENTS OF IATA ON  
DG COMPETITION CONSULTATION PAPER CONCERNING  
REGULATION 1617/93**

**IATA TARIFF CONFERENCES:  
WHAT THEY DO AND DO NOT DO**



## **IATA TARIFF CONFERENCES: WHAT THEY DO AND DO NOT DO**

This annex provides a detailed description of the IATA Tariff Conference process and discussions for both passenger and cargo. The detailed description is designed to illustrate the:

- The process to set interlineable fares
- Information discussed at the meetings and the restrictions on information that cannot be discussed as well as other safeguards.

We first provide an overall description of IATA tariff coordination and how it looks on a global and EEA basis.

### *Tariff Coordination*

Tariff Coordination is established through resolutions adopted at meetings of the IATA Tariff Coordinating Conferences by those IATA member airlines that have elected to participate. These Conferences are constituted under the Provisions for the Conduct of the IATA Traffic Conferences.

The IATA Tariff Coordination Conferences are divided into Passenger Conferences and Cargo Conferences. There are 14 Tariff Coordinating Conferences in total, consisting of seven Passenger and seven Cargo Conferences. These seven groupings are arranged on the basis of routes within and between three defined geographical regions. Three cover routes within each of the three IATA Areas, and the other four cover routes between those areas.

The three IATA Areas are defined as follows:

- Area 1 which encompasses all of North and South American continents and the islands adjacent thereto, Greenland, Bermuda, the West Indies and the islands of the Caribbean Sea, the Hawaiian Islands (including Midway and Palmyra);
- Area 2 which is comprised of all of Europe (including that part of Russia located west of the Urals) and the islands adjacent thereto, Iceland, the Azores, all of Africa and the islands adjacent thereto, Ascension Island, that part of Asia lying west of and including Iran; and
- Area 3 which encompasses all of Asia and the islands adjacent thereto except the portion located in Area 2, all of the East Indies, Australia, New Zealand and the islands adjacent thereto, the islands of the Pacific Ocean except those included in Area 1.

These three areas can be clearly seen in the diagram overleaf.



**Table 1: Conference areas – voting member counts**

Conference area	Voting Members	EEA based Voting Members
<b>Passenger:</b>		
TC2	77	32
TC12	60	20
TC23	69	15
World-wide	128	32
<b>Cargo:</b>		
TC2	56	20
TC12	51	16
TC23	58	12
World-wide	95	20

*Source: IATA.*

*Note that TC2 includes within Europe and between Europe and Africa Middle East, TC12 includes between Europe and the Americas, and TC23 includes between Europe and Asia, Pacific.*

We have noted above that the decision to participate in Tariff Coordination is an individual decision for each airline member of IATA. While any IATA member may participate in Tariff Coordination Meetings, only those that operate international services are entitled to vote. At present, 133 of the 271 IATA member airlines have elected to participate in Tariff Coordination activities.

Of the 138 IATA member airlines that do not participate in IATA Tariff Coordinating Conferences, 18 airlines provide domestic services only. Many of the remainder are small regional operators, which may not be able or willing to extend the resources necessary to participate in meetings of the Conferences, although they are able to participate in interlining and apply the tariffs established in Conferences, if they choose to interline.

The next section provides a detailed description of the composition and functioning of each of the IATA Tariff Conferences for passenger and cargo.

#### *Detailed description of IATA Tariff Conferences*

IATA Tariff Coordinating Conferences are established under the Provisions for the Conduct of the IATA Traffic Conferences. Their role is confined to the establishment of fares, rates and related conditions. Flight schedules, frequencies and capacity do not come within the scope of the Conferences. The terms of reference for the Conferences are provided in the Provisions as follows:

*The aims, objects and purposes of the Traffic Conferences shall be those of IATA, and nothing contained herein nor action taken pursuant hereto shall be inconsistent with the Articles of Association of IATA.*

*Each Passenger Tariff Coordination Conference shall concern itself with the analysis of relevant operating costs and take action to develop passenger fares and related conditions in respect of the area of authority of such Conference.*

*A Composite meeting of Passenger Tariff Conferences shall take action on those matters and practices relating to fare construction and currency rules (other than those which by their own terms are applicable only to one Passenger Tariff Conference), conditions of service, baggage allowance and charges, remuneration levels of recognized passenger sales intermediaries<sup>1</sup>, and such other matters as may be referred to it by any Passenger Tariff Conference.*

*Each Cargo Tariff Coordinating Conference shall concern itself with the analysis of relevant operating costs and take action to develop cargo rates and related conditions in respect of the area of authority of such a Conference.*

*A Composite meeting of Cargo Tariff Conferences shall take action on those matters and practices relating to rate construction and currency rules (other than those which by their own terms are applicable only to one Cargo Tariff Conference), conditions of service, baggage allowance and charges, remuneration levels of recognized intermediaries engaged in the sale and/or processing of international air cargo, and such other matters as may be referred to it by any Cargo Tariff Conference.*

It should be noted that where the terms of reference refer to Tariff Coordinating Conferences taking 'action' this is a reference only to the Conferences passing resolutions. Neither the Conferences nor IATA take any other action in relation to these matters.

IATA provides the secretariat for the Conferences. IATA has no other involvement in establishing tariffs. The Conferences are autonomous meetings of the Member airlines.

The seven passenger and seven cargo Tariff Conferences are further divided into 57 regions called sub-areas. Call of Meeting messages are issued to convene meetings of the Areas or sub-areas which will consider the identified routes. All members of TC2 will receive the Call of Meeting and agenda for the TC2 Within Europe meeting and are entitled to attend and vote, but in practice only the airlines with a direct interest attend. These are the airlines based in Europe as defined in The First Schedule attached to the Provisions for the Conduct of IATA Traffic Conferences. This area extends from Morocco to Russia, and from Ireland to Azerbaijan.

A joint meeting of all the IATA Passenger Tariff Coordination Conferences is held annually to address matters of a worldwide nature such as fare construction rules, baggage and currency rules. An equivalent meeting is also held for the Cargo Tariff Coordinating Conferences every two years. These joint meetings are referred to as 'Composite' meetings.

The Provisions also envision the possibility of joint passenger and cargo meetings, however these have not been held for a number of years.

All actions taken by a Tariff Coordinating Conference are in the form of resolutions. A resolution can only be adopted, or amended, on the unanimous affirmative vote of those IATA members present and having a vote in the particular Conference Area.

Airlines providing 3<sup>rd</sup> and 4<sup>th</sup> freedom services within a Conference area automatically have a vote, while those providing 5<sup>th</sup> freedom services may elect to vote if they so wish. An airlines may also elect to vote in a Conference in an area in which it does not operate provided the Conference bears the numeral of one of the geographic areas of the Conference in which they are a voting Member. For example, an airline operating in TC3 may elect voting rights in TC31, TC23, or TC123 whether or not they operate services between TC3 and TC1, between TC2 and TC3, or between TC3 and TC1 via TC2.

In order to exercise its right to vote at a Tariff Coordinating Conference meeting, an airline must appoint an accredited representative to that Conference. The accreditation, which must be signed by the chief executive of the airline, certifies that the appointee has full power and authority to reach agreements on behalf of the airlines, and has full power and authority to designate an alternate to act in his/her place.

Depending upon whether a meeting is convened to address an agenda for an entire Conference area (e.g. TC3), a sub-area (e.g. TC2 Within Europe), or less than a sub-area (e.g. TC12 Europe-Canada), slightly different quorum rules apply.

In the first case, one-third of the voting members of the Conference area must attend to achieve a quorum. For a sub-area meeting, either one-third of voting members of the Conference area or one-half of the voting members of the sub-area constitutes a quorum. In the last case, a quorum is achieved if either of the above conditions are met or if 80% of the 3<sup>rd</sup> and 4<sup>th</sup> freedom operators are represented at the meeting.

As mentioned above, meetings of the Tariff Coordinating Conferences are normally held each year for passenger matters and every two years for cargo matters. For the passenger conferences, as many as 25 individual meetings are held each year to address matters relating to the various Areas, sub-areas and regions, as well as the joint meeting of all seven Conferences to address global issues.

In a typical year, there would be eleven passenger Conference meetings involving routes to/from or within Europe as follows:

- TC2 Within Europe (Spring)
- TC2 Within Europe (Autumn)
- TC2 Europe-Middle East
- TC2 Europe-Africa
- TC12 Canada, USA-Europe

- TC12 Mexico-Europe
- TC12 Mid Atlantic, South Atlantic-Europe
- TC23 Europe-South Asian Subcontinent, South West Pacific
- TC23 Europe-South East Asia
- TC23 Europe-Japan, Korea
- Composite

There would normally be a meeting of the Cargo Conferences involving routes to/from Europe every two years.

Special meetings may be convened, on a minimum 15 days notice for such time, place and purpose (within their terms of reference) that IATA's Director General or Board of Governors may determine.

Regular Conference meetings are convened on at least 90 days notice. The notice of meetings sets out the meeting dates, the matters to be discussed, deadlines for agenda submissions, the venue and any necessary information in respect of the meeting location. The Provisions for the Conduct of the IATA Traffic Conferences, which regulate Tariff Coordinating Conferences, provide:

*“The Secretary shall give at least 90 days’ notice by mail, telegram or cable to each Member of a Tariff Conference before the date fixed for any regular meeting, and such notice shall contain the date, the place and the provisional agenda of the meeting, except that only 15 days’ notice of a special meeting requested by the Director-General or the Board of Governors need be given.”*

The notice also reminds participants of their obligation to be properly accredited and the requirement that submissions be made in accordance with the Provisions for the Conduct of the IATA Traffic Conferences.

Approximately four weeks before the agenda deadline, or two months before the meeting, IATA issues agenda transmittal number 1. This document:

- Reminds participants of the meeting dates and associated deadlines for their submissions to the agenda;
- Provides participants with the necessary forms should they need to amend or update their accreditation;
- Sets out, in the agenda subject outline, the subjects for discussion including all resolutions that are currently adopted by the Tariff Coordinating Conference for application in the area concerned and which are due to expire;
- Provides administrative items, such as ‘approval of minutes of previous meetings’, voting membership and the status of the resolutions adopted at the previous meeting;

- Provides any submissions of a technical nature being made by IATA itself; and
- Facilitates the agenda preparation process of participants by consolidating, in a single table, provisions such as seasonal periods and local currency charges (and their equivalents) that are contained in the text of various resolutions for the area. These items are generally those that are frequently updated by the Conference.

*What is discussed by a Conference.*

Members wishing to make a proposal for consideration by a meeting of the Conference must submit their proposals to IATA at least 40 days in advance of the meeting.

Proposals typically include changes to the IATA fare, rate or add-on levels, the associated conditions, or changes to any of the fare or rate construction resolutions, passenger baggage or currency resolutions for the area. Submissions may also include proposals to introduce or cancel fares or rates for pairs of cities where new operations have been added or existing operations deleted, add new add-on cities or amounts, or to add new fare construction, baggage or currency resolutions that may be required from time to time.

*What is not discussed by a Conference.*

Discussions are limited to IATA fares, rates and conditions that are applied on an interlineable basis and may not include discussions on individual carrier fares, rates and conditions nor on the capacity to be offered by the members.

*For each Conference meeting.*

IATA reviews each proposal to ensure that it is within the terms of reference of the applicable Conference and that it is self-explanatory and understandable. Where necessary, IATA contacts the proponent seeking clarification. IATA distributes a copy of the submissions received to the voting members of the area concerned and to any other Tariff Conference member that wishes a copy 30 days in advance of the meeting as agenda transmittal number 2.

The Provisions for the Conduct of the IATA Traffic Conferences permit 'late submissions'. IATA collects these proposals and circulates them by e-mail. Extra hard copies of these proposals are available to Conference delegates on the first day of the meeting.

Immediately prior to the meeting, the secretary of the meeting prepares an order of business – a document that sets out the sequence in which the chairman of the meeting will consider proposals on the agenda.

For each meeting there are two officers, the Chairman and a Secretary. The chairman is usually a retired former employee of an IATA member but is in all cases an individual with some experience in the processes.

IATA assigns chairmen to each individual meeting of the Tariff Coordinating Conferences. The Chairman does not have a role in setting the agenda or any advance preparation for Conference meetings.

The most important function of the Chairman is to maintain good parliamentary order at the meetings and to protect the rights of all participants to be heard. The Chairman is expected to exercise impartiality with respect to all decisions he or she is required to make.

In the management of the Tariff Coordinating Conference meetings, the order of business follows a standard parliamentary format, i.e., a call to order, approval of the minutes of the last meeting, reports of committees (if any), completion of old business, consideration of new business, and so forth. The chairman is expected to manage the meetings in an efficient and impartial manner.. (this is not a 'rule' in the provisions; I would omit it) (As edited I would leave it in)

The Secretary is an employee of IATA and is supported by a team of specialists who are also IATA employees.

The Chairman leads the meeting through the consideration of all the submissions on the agenda, seeking a consensus. Submissions proposing to amend the current resolutions, or expedited proposals, are considered first, followed by the submissions related to the new agreement.

Inevitably there may be conflicting or contradictory proposals and it is the Chairman's objective to bring all participants to the point where they are in agreement. Consensus is required for a meeting to reach an outcome, however this should not be interpreted to mean that the airline proposing the highest tariff on a particular route carries the Conference meeting as airlines often have quite divergent interests.

At the final stages of the meeting, the Secretary, as directed by the Chairman, prepares 'Resolution documents' which show each and every change to the package of resolutions applicable in that Area. Any changes to fare levels are stated in the form of instructions for IATA to follow in the production of its fares or rate tables. These Resolution documents are presented to the meeting at the final stages to ensure that all present are in agreement. Following the meeting, IATA issues detailed minutes of the deliberations. Those minutes record the discussion and decision on each proposed resolution change. In addition IATA prepares and distributes documents reflecting the actual amended Resolution text, and fares or rates tables.

Tariff Conference Members who are not entitled to vote at a meeting for a particular Area or subarea can nevertheless attend the meeting and provide comments.



IATA Tariff Coordinating Conference meetings are open meetings: governments and bodies such as the European Commission are entitled to send observers.

In addition, any person:

- Has the right to receive copies of the agenda of any Tariff Coordination Conference meeting subject to payment of charges set by the secretary from time to time. Charges reflect the cost of providing those documents.
- May submit a specific written proposal on any subject or matter pending before a Conference to the Secretary who must then refer to the proposal to the appropriate Conference. The Secretary will inform the proponent of the action taken and the outcome thereof.

However, this happens infrequently.

If any such person wishes to make an oral presentation in support of a written submission, there is a process by which the chairman and the secretary may permit that person to do so, depending on the importance of the subject matter of the submission, the practicability or otherwise of including the substance of the oral presentation in the written submission, the number of other requests and the time and convenience of the Conference.

As mentioned above, all action is in the form of a Resolution. Tariff Coordinating Conference resolutions fall into two broad categories – Composite resolutions that have worldwide application and fares and rates resolutions which apply in relation to a specific region. Fares and rates resolutions are normally effective for one year in relation to passenger resolutions and two years for cargo resolutions.

The Provisions for the Conduct of the IATA Traffic Conferences also allow for Resolutions to be adopted or amended by mail vote. In these cases the requesting member provides IATA with its proposal which is then circulated by e-mail to the voting members for consideration. If adopted, the resolution is submitted for government approval in the same manner as other Resolutions.



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**ANNEX VI**

**COMMENTS OF IATA ON  
DG COMPETITION CONSULTATION PAPER CONCERNING  
REGULATION 1617/93**

**THE EXTENT AND BENEFITS OF IATA INTERLINING:  
AN ECONOMIC ASSESSMENT  
BY CHARLES RIVER ASSOCIATES**



Redacted\*



**The Extent and Benefits of  
IATA Interlining:  
An Economic Assessment**

By

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**September 2004**

\* [...] denotes confidential information omitted from this version.



# The Extent and Benefits of IATA Interlining: An Economic Assessment

## INTRODUCTION

On 30 June 2004, DG Competition published a consultation paper concerning the revision and possible prorogation of Commission Regulation 1617/93 on the application of Article 81(3) to IATA tariff conferences for passengers and cargo. The consultation paper analysed the IATA tariff conferences in terms of their restrictive effects and the potential benefits from enabling passengers and cargo to pass onto the networks of different airlines in the context of the IATA multilateral system. Charles River Associates (CRA) has been asked by the International Air Transport Association (IATA) to analyse the benefits derived by consumers and cargo shippers from their ability to purchase and use the IATA interline system.

## VIEWS SET OUT IN THE CONSULTATION PAPER

CRA considers that the main economic considerations on the IATA interlining system set out in the consultation paper may be summarised in the following:

- (Paragraph 61) Consumer benefits may be attributable to the IATA interlining system but have decreased substantially with the development of individual airline alliances and/or other bilateral agreements between air carriers as concerns intra-EEA air travel. In particular, the consultation paper considers that the benefits identified by IATA in respect of “through fares” and “through check” of baggage have to a large extent been overtaken following the development of airline alliances.
- Itinerary flexibility (defined in paragraph 56 of the consultation paper as the ability to move across the network of more than one alliance) appears to be a consumer benefit which is specific to the IATA interlining system. However, the consultation paper considers that it remains uncertain to what extent consumers make *use* [italics added] of that specific feature of the IATA Interlining system.
- For routes between the EU and third countries the scope of alliances are considered to be more limited and therefore through fares and through check of baggage as well as flexibility are all accepted as current benefits of the IATA Interlining system (paragraphs 93-94).
- Efficiency gains for airlines as a result of the IATA system are considered to be very limited (paragraphs 48-49 and 87).

- For cargo, the consultation paper has identified no benefits that derive from the IATA Interlining system (paragraphs 105-108).

CRA notes that the consultation paper contains no data to support the points identified above and that the consultation paper has not addressed the data provided in the previous consultation exercise in 2001, which addressed both the benefit and the extent of interlining within the EEA. CRA has reassessed the benefits of the IATA interline system and concluded that the IATA interline system continues to provide substantial benefits. This paper summarises the analysis of the data provided to CRA. We conclude that there are clear benefits in terms of efficiencies and direct consumer welfare gains associated with the IATA conference system for both passengers and cargo.

In this paper we first identify what is IATA interlining before defining the benefits of the system.

### **WHAT IS IATA INTERLINING?**

Air transport satisfies specific consumer needs for travel to destinations that cannot be reached on a timely basis by other forms of transport. In some cases the specific needs of consumers can be satisfied by a single flight between two airports. In other cases, the specific needs of individual consumers may only be satisfied by multiple connecting flights. In choosing between air transport alternatives, consumers value schedule, elapsed time, comfort, and the flexibility to change their plans.

Interlining, as facilitated by the IATA passenger tariff conferences, consists of travel or potential travel involving multiple airlines on a single ticket, bought in a single transaction, using a single currency, which offers a passenger through-checked baggage, and a high degree of flexibility as to choice of timing, routing and carrier. The IATA tariff conferences are at the core of the joint fares and common standards and systems for reservations, tickets, passenger handling, baggage, and data transfer that make multilateral interlining possible and efficient.

To achieve an efficient interlining service, the IATA system relies on extensive commitments: to accept the customers of other participating carriers at mutually agreed fares even where the passengers change their plans; to facilitate the coordination of booking information and baggage handling; and for the ticket issuer to pay all booking costs and to reimburse the airline(s) that carry the passenger.

The joint multilateral product of the airlines, the IATA interline ticket, is a product that cannot be produced by any airline or alliance on its own. It is a product that enables travellers to travel how they want to, in getting to their final destination. The multilateral interline product gives

consumers the *flexibility* to choose the schedule and the routing that meets their needs, and to change the schedule and routing should their needs change.

## **THE RELEVANCE OF IATA INTERLINING TODAY**

Throughout the consultation paper there are references to the growth and deepening of alliance networks in the EEA, with the implication that this development could provide an alternative to the type of benefits illustrated above and provided for by the IATA interline system and/or that the benefits of the IATA system will as a result tend now to be much lower than in the past.

It would require a detailed analysis to determine whether alliances have indeed broadened and deepened since 2001, but it does not appear that there has been any empirical analysis of the issue in order to support the assertions in the consultation paper. However, it is highly unlikely that the alliances have broadened to the extent that they can replicate the 366 destinations within the EEA, or the 1430 destinations in third countries, that European consumers can access with IATA fares. It would appear appropriate to assume that the benefits identified by IATA in its response to the 2001 consultation paper are broadly applicable; at least, we can safely say that the benefits of the IATA system have not gone away. Furthermore the consultation paper has failed to recognise that fares to these 366 EEA destinations are all potential components of an IATA interline ticket involving travel between the EEA and third countries - travel for which the consultation paper states that individual airlines or individual alliances are "neither sufficiently global nor efficient from a purely economic standpoint for the purposes of offering from the consumers' perspective a credible and valuable alternative to the IATA Interlining System" (paragraph 93).

In the next section we identify the types of benefit the IATA interline system brings to airlines and consumers.

## **WHAT ARE THE TYPES OF BENEFITS FOR EEA CONSUMERS AND AIRLINES?**

Economic literature emphasises the benefits to consumers of the deepening of networks. In relation to the airline industry, DG Competition has recognised this point in its merger decisions relating to Air France / KLM and United Airlines / US Airways,<sup>1</sup> and in paragraph 30 of the consultation paper.

The IATA tariff conference system provides the means by which airlines can access, using mutually agreed interline fares, the networks of other airlines. IATA fares exist connecting 366 EEA destinations, providing access for airlines over and above the existing scope of intra-EC

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<sup>1</sup> Case No COMP/M.3280 - Air France / KLM, Case No COMP/M.2041 – United Airlines / US Airways.

alliances and single carrier networks, and equivalent access to 1430 destinations to and from the EEA. The IATA tariff conference system provides both airline and consumer benefits.

### *Benefits to airlines*

The IATA system of interlining is especially important for small and regional airlines that can obtain much greater scope in the number of origins/destinations that they can offer to passengers and greater economies of density (better load factors) on the routes they serve. Small and regional airlines can achieve this by participating in the IATA European Conference and/or simply by being members of MITA – an agreement under the auspices of IATA – whereby participants may match, for interline poses, the IATA tariffs agreed by the conference and the associated common standards in the knowledge that the IATA participants will accept the passengers at the fare collected.

In essence this means that given uncertain demand flows, the IATA system provides airlines with important additional sources of passengers. This will allow the airlines to operate at higher capacity utilisation and therefore at lower average total cost per seat. In the long run, because almost all airline operating costs are variable, market prices will tend towards this lower average total cost. In other words, given the level of competition in the airline industry and the historically low average returns, we have every reason to believe that this extra productive efficiency will be translated into consumer benefits in the long run. We consider that the consultation paper is incorrect in paragraph 49, to dismiss this type of benefit that is a function of the deepening and extension in the scope of airlines' networks as a result of the existence of the IATA system. We also note as an aside that the data indicating that smaller operators typically carry more interline traffic, might also suggest that the smaller operators gain much of the benefit of this effect. This point is likely to be of particular importance to the relatively smaller carriers based on the periphery of the EEA in ten new Member States.

### *Benefits to consumers*

The IATA interline system described in the previous section has three principal benefits:

- a) More convenient and lower cost services for connecting passengers and cargo;
- b) Flexibility, particularly for time-sensitive passengers and cargo; and
- c) Reduced transaction costs.

We look at each type of benefit in turn.



*(a) Connecting services*

The IATA interline system enhances the ability of passengers to travel between cities that are not served directly by an on-line service, or where the on-line services are limited in frequency or fully booked at the time that the customer needs to travel. The IATA system creates substantial benefits by facilitating through booking and transfer of baggage.

Furthermore the IATA system reduces the total fare for the itinerary below the fare that would apply if it were based on the fare charged by each participating airline for point-to-point traffic on the individual city pairs that make up the itinerary (*i.e.*, the sum of the sectors fare).

IATA has provided us with examples of a number of routes A-C (see Annex III) involving an intermediate point B, where the IATA fare is less than the sum of the individual fares for the two sectors A-B and B-C. The sector fares used are the most flexible business class fare available on that sector where rules allow the fare to be combined with other fares on a single ticket. We note that it is common for airlines to price fares within their own networks in such a way that longer routes are priced at a lower per kilometre rate, all else equal. It is also common for a short leg purchased as part of a longer itinerary to be significantly cheaper than the sum of the short and long sector purchased separately. Examples may include a domestic feeder service leading into an international connection or a two international sector connection. The analysis provided by IATA shows that at least in some cases the IATA system allows the same benefit to consumers, but with fares that operate across existing carrier or alliance networks.

For cargo, the IATA system provides the means to get cargo from one destination to another, with the ability to ‘seamlessly’ transfer the cargo between operators where necessary. Cargo does not walk, and customs requirements make it necessary to ensure that arrangements are in place to transfer the cargo from, for example, one terminal/in bond holding area to another.

We understand from IATA that the dedicated freight operators such as UPS or FedEx use the IATA system to enable them to reach more destinations outside their network, and to cover urgent or part shipments that they cannot accommodate in their network for a variety of reasons.<sup>2</sup> The airlines are transporting cargo either through dedicated cargo planes and/or on passenger planes. The resulting economies of scope make it probable that a dedicated freight operator will not provide many of the services, and for small packages or unusual cargo the IATA system with its very low marginal costs provides a rate at which such shipments can economically be transported. Absent the IATA tariff system for cargo there would be a class of shipments where it would probably be uneconomic for the airlines to transport. This is because the IATA system

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<sup>2</sup> UPS advertise that they provide a ‘fast, reliable, airport-to-airport cargo service to over 100 US Airports and over 111 International Airports’ (<http://aircargo.ups.com>). While this is good coverage, this compares with the IATA system which provides access to 366 destinations with the EEA, and 1430 destinations outside of the EEA.





has very low transaction costs. With prices established for all routes, there is no need for expensive manual intervention to price and arrange shipments to odd destinations or on very thin routes.

*(b) Flexibility for time-sensitive passengers and cargo*

Passengers who choose to purchase an IATA interline ticket have the ability to change the itinerary of their flight, the carrier, routes (subject to certain distance limits) and add or delete stopping points. Taken together, these features provide a passenger with flexibility that is not matched by a ticket valid for transport on a single airline or within a single alliance.

However, contrary to the impression given in the consultation paper, it is *not* how the IATA ticket is in fact used that demonstrates the benefit to the passenger. The passenger purchases the IATA ticket for the *ability* to change plans with minimal delay and inconvenience. Arguing that value is created only by usage is akin to arguing that insurance only has value to those that make a claim in any particular year. Of course this is not the case, there is significant value to consumers purely in terms of risk management.<sup>3</sup>

Both benefit (a) and (b) imply flexibility involving the ability to move across networks of airlines or single airlines, whether point-to-point or connecting, whatever the extent of the relationship between the carriers beyond membership of the IATA tariff conference or MITA.

The improved connection and flexibility benefits are directly linked to the IATA tariff consultation system. The interlineable fares agreed in the context of IATA consultations provide a joint product on the basis of an equitable division of revenue. This provides the necessary incentive for participating airlines to accept other carrier's tickets and to create and maintain the links that facilitate through checking and baggage handling. Absent the IATA system, and any coverage by an alliance or other code sharing arrangement, any change in booking on route A to B to C would likely require passengers to purchase a new ticket for the remaining or new journey and to seek a refund for the remainder of the original ticket. In the case of transfers, the passenger would have to deal with baggage transfers themselves at any intermediate points in the journey and would have to allow much longer connection/transfer intervals. As an illustration of this point, we note that most airlines require passengers to check in at least one hour, and often cases two hours before their flight.<sup>4</sup> In addition sufficient time needs allowed to arrive (with the

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<sup>3</sup> Consumers who buy household insurance do not do so only if they think their house is *actually* going to burn down in the year they purchase the policy. However, there is considerable value in the assurance that if such a contingency does occur, the value of the house is not completely destroyed.

<sup>4</sup> An indication of what might be involved for intra-EEA travel is the "at least two hours between the scheduled time of arrival of the incoming flight, and the scheduled time of departure of the onward flight" that easyJet recommends its passengers allow if they are attempting to combine an easyJet flight with another easyJet flight (see <http://www.easyjet.com/en/book/regulations.html#onward> flights). Given the many long-haul services

possibility of delays), clear immigration, retrieve baggage and complete any customs requirements in sufficient time to re-check for the next segment. This contrasts with the interline connection times at the top 10 transfer airports in the EEA which varies from 30 to 90 minutes.<sup>5</sup>

The consultation paper appears to assume that alternatives to the IATA system based upon bilateral arrangements may be proposed. There can be no certainty that such bilateral arrangements between airlines will develop and these bilateral arrangements in many cases are unlikely to be constructed in such a simple and efficient way (costs would be higher), which therefore suggests that carrier fares designed to provide the same service would be likely to be higher than the IATA fares available today.

The US example is instructive. There is no IATA interlining on domestic flights though it is quite possible to interline bilaterally, subject to US antitrust laws. Airlines have bilateral agreements which allow for higher price tickets to provide for a measure of flexibility between the airlines. However, there is no ability under the US domestic system to obtain any sort of multilateral interlining option for journeys wholly in the US. Where this lack of agreed interlining results in separate tickets being issued, this may sometimes result in the passenger having to collect and recheck baggage at transfer points. The benefits of the IATA system are even more apparent when a passenger needs to change routes or flight timings, where this entails a change of carrier. In this case the passenger would have to be refunded the cost of the ticket and buy a new ticket<sup>6</sup>.

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between the EEA and third countries are operated only once daily, the connection interval that the prudent traveller would have to allow is likely to be even longer if the IATA system did not exist and the traveller was attempting to combine the services of two or more airlines that did not have a bilateral relationship.

<sup>5</sup> Minimum connecting times (international to international) are as follows: Frankfurt 45min, Copenhagen 45min, Amsterdam 40-50min, London Heathrow 45-90min, Zurich 40min, Madrid 45-60min, Athens 45min, Bodo 30min, Ljubijana 30-60min. British Airways, for example, requests that for all domestic UK and European flights that all passengers check in a minimum of one hour before departure. For long-haul flights they require Economy passengers to check in two hours in advance, Business class 90 minutes in advance and First Class one hour in advance. (<http://www.britishairways.com>)

<sup>6</sup> It may be asked why, in light of the benefits of multilateral interlining identified in this paper and the lack of any anticompetitive effects, the US has not reintroduced a system similar to the IATA system? The reason relates to the costs of creating the system, which are sunk costs for the airlines operating on EEA routes. The US system of interlining was dismantled amidst concerns in the late 1970s about coordinated behaviour between US airlines. Given the large sunk costs of creating the interlining system (as described earlier) and the smaller (but ongoing) incremental revenues it is perhaps not surprising that a multilateral interline system has not been recreated. Whilst there may have been legitimate public policy reasons for reducing the links between airlines in the regulatory world of the 1970s, it is another matter whether such government intervention is warranted in 2004 in the EEA given the lack of theoretical or empirical basis for concerns about the restrictive effects of the current IATA system (see CRA paper on the possible restrictive effects of the IATA system.) The data on purchases and usage of tickets at IATA fare levels suggests that a similar course of action within Europe would reflect in losses in economic welfare. The failure of US airlines to recreate a multilateral interline system suggests the need for caution in assessing the IATA system under Article 81 – once the system is dismantled it is unlikely that it can ever be rebuilt.

For cargo there is the inherent flexibility of being able to operate on any airline or any flight available to transport cargo to any destination. This will include urgent shipments (such as perishables where no delay can be accepted), irregular operations or where cargo capacity on a given onward flight is unavailable.

*(c) Reduced transaction costs*

Another key benefit of the IATA interline system in its current form is that it generates the benefits identified above using a unique joint product at a very low transaction cost for the participating airlines, compared to any alternative. Because the revenue distribution is based on a pre-agreed formula, there is no need for *ad hoc* intervention by airline employees to approve a ticket sale or a booking change. Furthermore, airlines do not need to invest management time in ongoing negotiation of bilateral arrangements with numerous partners, unless such negotiations are part of a broader strategic relationship.

If each participant in the IATA tariff conference needed to employ just one extra person for each of passenger and cargo at €50,000 each, the cost would be over €1.150 million. While larger airlines would be more likely to have levels of interline business that justify these higher costs,<sup>7</sup> it must be expected that higher transaction costs will be passed onto consumers.

On cargo the very fact that dedicated freight operators and forwarders utilise the IATA system for a percentage of their business (however small) indicates that this is the cheapest and more efficient way to get some cargo to all destinations. Furthermore, as noted above, there are categories of small and/or unusual shipments that may not be carried at all because the airlines simply will not bother due to the hassle involved and the relatively high transaction costs given the minimal revenue potential.

*Quantifying the benefits of the IATA interline system to airlines and consumers*

In 2001, the IATA response to the DG Competition consultation referred to the Economics Plus / GRI report for IATA, which came up with a global benefit of \$2.9 billion. IATA produced a rough estimate of €380 million (1998 prices) for the benefit for passengers in the EEA in 2001 based upon the revenue generated by intra-EEA travel (taking account of the distance flown). Assuming the GRA estimate of \$2.9 billion is still a reasonable global estimate, with traffic to/from EEA accounting for 26% of global revenue passenger kilometres,<sup>8</sup> this implies a benefit of \$754 million. Including traffic within the EEA, which increases the share to 35% or \$1.015

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<sup>7</sup> Although smaller airlines have a larger share of revenue from interlining, the total revenues are much smaller, and the total amount involved is also therefore normally significantly less.

<sup>8</sup> Source, IATA statistics.



billion of benefit, implies a within EEA benefit of \$261 million. This is equal to a within EEA benefit of €14.5 million,<sup>9</sup> and a benefit to/from EEA of €620 million.<sup>10</sup>

In the amendment to Regulation 1617/93, a mandatory data collection requirement was added in respect of passenger tariff consultations to facilitate the evaluation of the benefits of interlining.

The data supplied to DG Competition indicates that there are continued benefits to consumers in terms of flexibility and better connection possibilities. We draw some examples to illustrate:

- In 2003, of a total of 20,653,178 fully flexible business passenger coupons for intra-EEA travel, 7,734,720 coupons were at the IATA normal fare. Of this, 1,693,455 coupons or 21.89% were used for interlining. If we assume that one passenger trip is on average 2.2 coupons, then around 770,000 passengers *used* the IATA interline system to actually change itinerary or connect onto another airline to take them to a location. Both the number of purchases and the number using the ticket are substantially different from zero and represent an obvious indicator that the IATA tickets are valued.
- Even where a number of airlines compete and the number of frequencies each airline has is substantial, use of IATA tickets remains common. London–Amsterdam during the period July to December 2003 is an example. This is a route which is point-to-point and where passengers are purchasing over 20% of the tickets at IATA level rates, even when there are carrier fully flexible (on the particular airline) alternatives and where individual airlines have frequent departures. Passengers clearly want to utilise the flexibility of the ticket if it is required and 11.54% of total IATA level tickets were used for interlining purposes on this route.
- Although incomplete, the data gives some indication of the relative extent of interlining outside of the IATA system. In 2003 there were a total of 20,653,178 normal fare coupons used for travel within the EEA. As noted above, of this number 7,734,720 or 37.45% were at IATA fares and 1,693,455 were actually interlined. In contrast, the number of non-IATA carrier normal fare coupons that were interlined was less at 1,237,484.

From an economic perspective, people reveal their preferences by their actions. When passengers choose between various options they are implicitly placing a value on the product vis-à-vis other products. In the first example we illustrate that people actually purchase *and* use the ticket to interline, however, this is not necessary from a consumer welfare perspective: what matters is that people are purchasing the ticket, despite carrier alternatives (albeit imperfect), because they value the unique IATA product.

<sup>9</sup> The difference from the earlier 2001 estimate of €380 million is accounted for by significant exchange rate movements, and changes in share of RPK.

<sup>10</sup> Using a USD/EUR exchange rate of 0.822. Source: OANDA.com, 2 September 2004.



We asked IATA to provide us with data from five selected airports and assessed the difference between the IATA fully flexible fare and the on-line business fares for non-stop flights. The results are contained in Annex B. The differences are substantial. Across the five destinations the difference in 2004 ranges between 0.0% and -53.3%, with carrier fares significantly lower in almost all cases. There will be both demand and supply side reasons for this difference. This range will of course differ across routes due to differences in conditions of competition for business travellers across specific routes. Nonetheless, with the introduction by airlines of on-line business fares that include restrictions (in particular, that they are carrier specific), the continued purchase of IATA fully flexible tickets by business travellers reveals that they value the flexibility the ticket brings even though it may be more expensive.

## **THE EXTENT OF INTERLINING IN THE EEA AND FURTHER AFIELD**

In this section we will provide some macro estimates of the extent of use of passenger and cargo interlining globally. We have already noted that this is a subset of the consumer welfare benefits of interlining but it allows us to provide some global estimate on which to work. We will then report the previous data provided to the economics consultancy, London Economics, as part of the consultation exercise in 2001 on the number of passengers who have purchased the IATA ticket for the ability to be flexible in their itineraries within the EEA.

### *The global macro importance of interline usage*

CRA asked IATA to provide revenue data on the *use* of interline tickets, as this was the easiest data to collect in the time available. The data looks at the revenue that different IATA member airlines across the world generated in 2003. The data provides information for IATA members for eight regions in the world; Europe, North America, Latin America, Africa, Japan and Korea, China, Middle East and rest of Asia.

We report the methodology in Annex 1 to this paper. We note that the definition of revenue facilitated by the IATA system will include not only the IATA interline ticket revenue but other forms of interlining. The main results indicate that for small airlines (those with low total revenues) the IATA system revenue represents on average a relatively larger proportion of their total revenue. Examples include [Names of Four Airlines]. On the other hand, for large airlines, IATA system revenue represents a smaller percentage of their total revenue, albeit with higher total value due to the much larger revenue base.

### *Extent of passenger interlining within the EEA*

In 2001, London Economics, on behalf of IATA, asked airlines within the IATA passenger tariff conference to provide answers to two questions:

- (1) What percentage of your total intra-EEA traffic is sold at IATA fully flexible fares?
- (2) What percentage of (1) above is then used for an interline journey?

At the time, London Economics reported that the data was difficult to obtain and was necessarily for one year. The data does not always allow for easy comparison and only provided a snapshot in any one year of the flow of passengers using IATA tariff tickets and the value to the airline.

The data provided to London Economics was summarised in the following table:

**Table 1: Interline Statistics for various airlines (Intra-EEA travel)**

Airline	(1) (Year)	(2) (Year)	(3) (Year)
<b>British Airways</b> <sup>11</sup>	[..] (2000)	[..] (2000)	[..] (2003)
<b>Air France</b>	[..] (2000)	[..] <sup>12</sup> (2000)	[..] (2003)
<b>Alitalia</b> <sup>13</sup>	[..] (2000)	[..] (2000)	[..] (2003)
<b>Finnair</b>	[..] (2000)	NA	[..] (2003)
<b>Iberia</b>	[..] (2000)	NA	[..] (2003)
<b>Sabena</b>	[..] (2000)	NA	[..] <sup>14</sup> (2003)
<b>SAS</b> <sup>15</sup>	[..] (1999)	NA	[..] (2003)

Notes:

- (1) The percentage of fully flexible IATA tickets.
- (2) The percentage of (1) actually used for interline purposes.
- (3) 2003 Figures supplied to DG Competition for the number of passenger trips at an IATA normal fare. These fares are coded C & Y fully flexible fares.
- NA Not available.
- Footnotes taken from the original LE report.

The data suggested in 2001 that:

- Carriers that have extensive networks and are members of alliances, such as [Name of airline] and [Name of Airline], nonetheless engage to an appreciable extent in IATA interlining. The figures are above the 10% figure offered by DG Competition in its 2001 consultation document.
- The extent of interlining increases where the carrier does not have such an extensive network and therefore relies on interlining to provide the ability to offer its passengers more travelling options. [Name of Airline] high estimates in 2001 may have reflected this.

<sup>11</sup> We understand that BA excluded all fare basis codes associated with carrier fares and all industry fares which do not offer flexibility, and all data that appeared suspect. BA however included Eurobudget fares, on the basis that although they do not offer the flexibility of a full business or economy fare, where they exist, they are the most flexible industry fare product available in the economy cabin. BA have also included a fare basis code which became carrier-restricted on 19 December 2000. The effect of this will be to overstate, fractionally, the percentage of tickets issued at fully flexible industry fares, but fractionally understate the proportion of these actually interlined.

<sup>12</sup> The number of passengers using their fully-flexible tickets was determined by counting the coupons of other carriers, whose passengers travelled on the Air France network and comparing this with the financial flows between Air France and other carrier for Air France passengers using these other carriers' networks.

<sup>13</sup> These figures represent estimates of the proportion of revenue for tickets sold at IATA levels and their usage.

<sup>14</sup> SN Brussels figure.

<sup>15</sup> These figures concern traffic within Europe but unfortunately not necessarily based on the origin and destination lying within the EEA.

- It appears from the Table 1 that the actual use of IATA fully flexible tickets is more than DG Competition suggests. In the case of [Name of Airline] around 30% of these tickets were used for interlining purposes.

As mentioned earlier the data supplied to DG Competition by the airlines is incomplete and based on more than business class fares, but still suggests that in 2003 airlines reported significant purchases of tickets at IATA fare levels. This can be seen from the third column of Table 1 which provides estimates of the amount of tickets purchased at IATA normal fare levels in 2003 for the airlines that provided data to London Economics in 2001.

**Table 2: Carrier Share of Interline Traffic (Worldwide)**

Carrier	Country	% Interline	
		Traffic	Revenue
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]
[Name of Airline]	[..]	[..]	[..]

\* Approximation

Source: Carrier data provided to IATA.

IATA has during this consultation exercise contacted a number of airlines flying routes to and from the EEA and within the EEA, asking for information on the extent to which they interline. The data is contained in Table 2 above, and shows the carrier figures provided on the total traffic and revenue that each carrier earns from interline traffic.<sup>16</sup> The data also provides more evidence that the benefits to consumers to and from the EEA destinations are substantial.

<sup>16</sup> Interline traffic includes all interline activity, not just IATA multilateral interlining.





## **CONCLUSION**

The IATA tariff conferences provide consumers and airlines with the ability to travel flexibly and to reach more destinations more easily. The need for IATA interlining can be clearly seen from the continued purchase of the tickets when there are (cheaper but more restrictive) carrier alternatives available. The continuing demand for the IATA product continues to demonstrate its value, and this is the case regardless of any expansion of code sharing within alliances and other bilateral agreements that may have taken place since 2001.

CRA has reassessed the data provided in the 2001 consultation and looked at various current data sources on the extent of interlining, including the data provided to DG Competition. From an economic perspective there appear to be clear benefits in terms of efficiencies and direct consumer welfare gains that are associated with the IATA conference system for both passengers and cargo. While these benefits are not fully quantifiable, there is sufficient evidence to establish that benefits exist and that they are material.

## **ANNEX A: DATA ON INTERLINE REVENUE PASSING THROUGH IATA SYSTEM FOR AIRLINES GLOBALLY ON PASSENGER AND CARGO TRAFFIC**

The data shows the revenue (in US dollars) that was cleared by each one of the airlines through the IATA interline system. The data also shows each airline's total revenue from all the different sources (i.e. IATA and non-IATA systems), as reported by the airlines to the Air Travel Intelligence.

Revenue from the IATA system is broken down into four different categories:

- Passenger-related revenue from interlining facilitated through the IATA system.
- Passenger-related revenue from interlining facilitated through the IATA system but using the Universal Air Travel Plan (UATP) credit card – an industry wide credit card.
- Cargo-related revenue from interlining facilitated through the IATA system.
- Other revenue (different from passenger and cargo) generated through the IATA interline system.

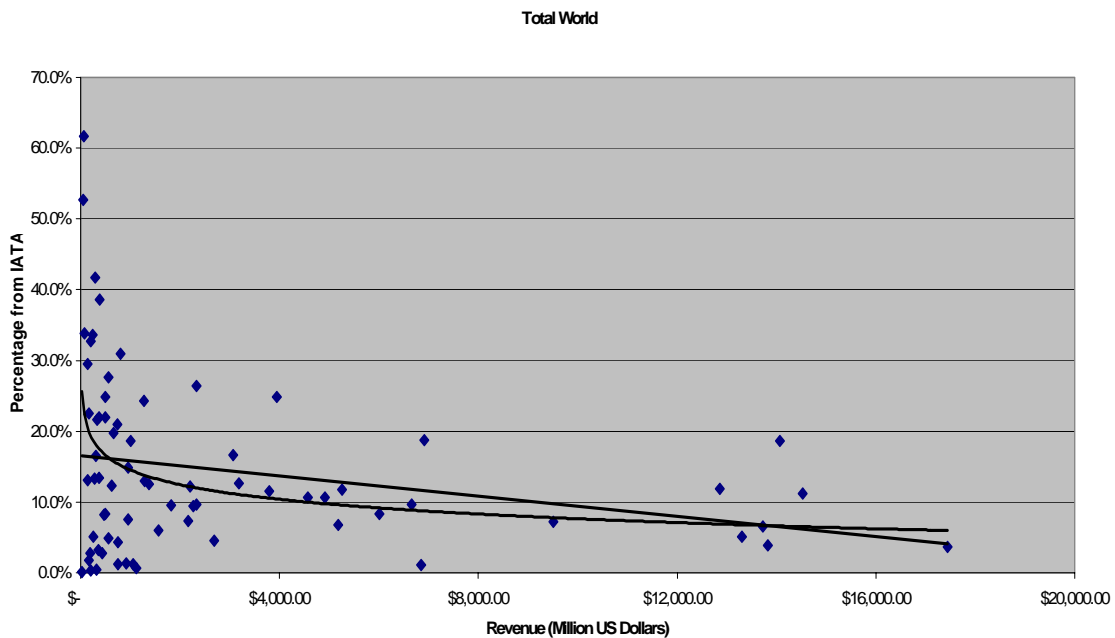
"Interline revenue facilitated by the IATA system" is defined as revenue that was collected by one airline but the service was performed by another airline/airlines and distribution of revenue between the carriers has been performed through the IATA Clearing House system. Settlement through the IATA System occurs for tickets issued using IATA fares or any other documents accepted for interline transportation. The information therefore extracted tells us that the revenue is to be exchanged between carriers and not what type of fare, IATA or non-IATA, was used to price the ticket nor for transportation documents for all on-line (single carrier) services. In other words, IATA interlining is a subset of the interline revenue *facilitated* through the IATA system.

Total revenue is broken down into three categories:

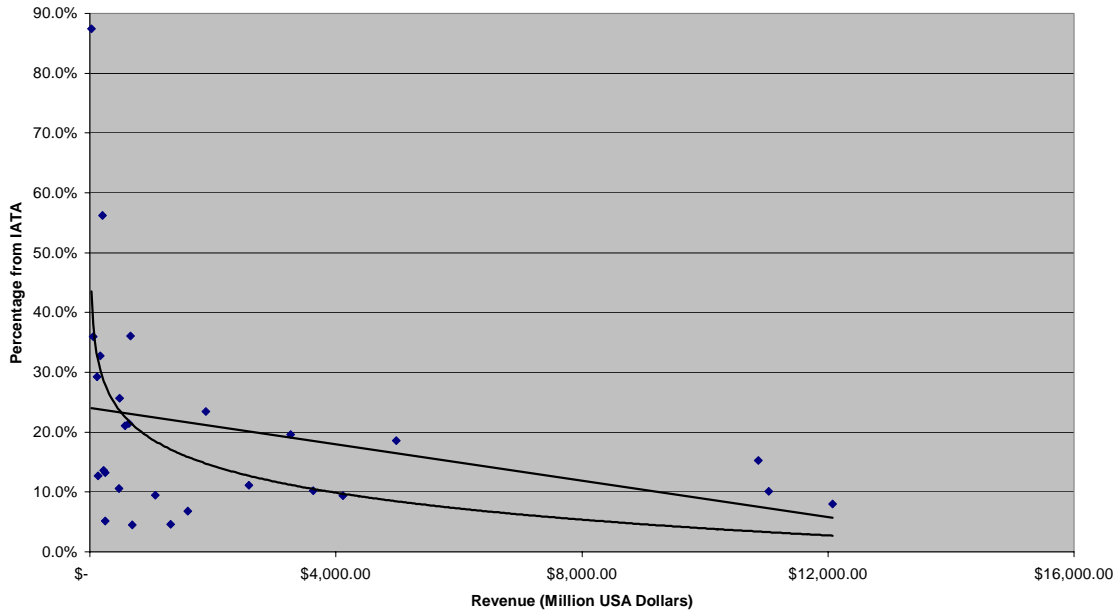
- Total passenger-related revenue as reported by the airline – includes IATA and non-IATA revenue.
- Total cargo-related revenue as reported by the airline – includes IATA and non-IATA revenue.
- Other revenue (different from passenger and cargo) generated through the IATA and non-IATA systems.

In some cases only aggregated IATA revenue and aggregated total revenue was available, i.e. the data was not broken down by passenger-related services, cargo-related services and others. These airlines were not considered in the analysis at passenger and cargo levels.

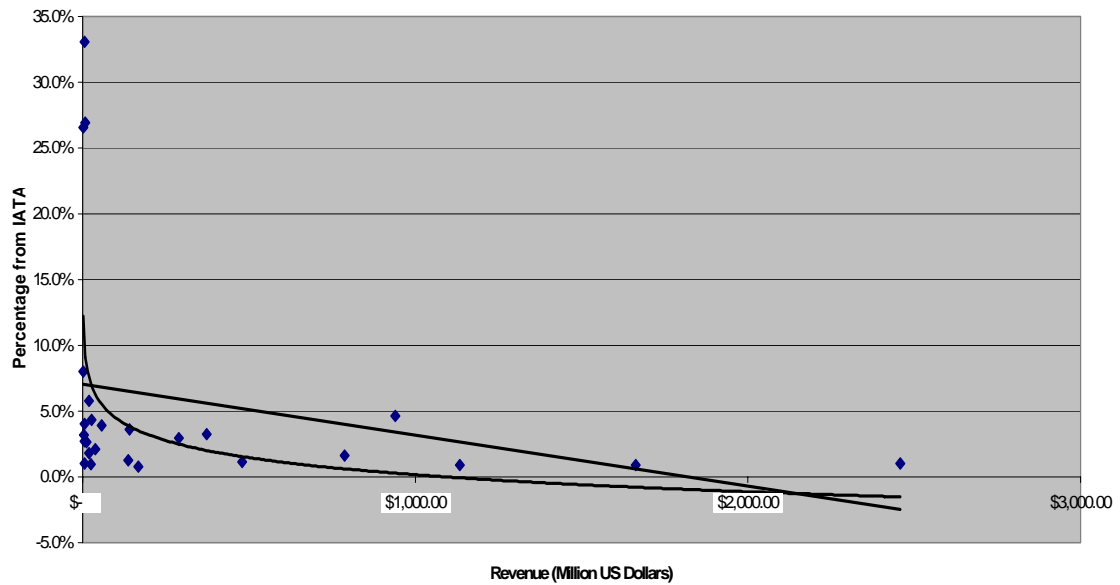
The main result evident in the data is that for small airlines (those with low total revenues) the IATA system revenue represents on average a relatively larger proportion of their total revenue. Examples include [Names of Four Airlines]. On the other hand, for large airlines, IATA system revenue represents a smaller percentage of their total revenue, albeit over a larger revenue base. This trend is evident in the following scatter plots, which illustrate the trend in the data. The scatter plots shown cover all operator revenue (global), and passenger and cargo operations of operators based in the EEA. Although not shown, the trend is also evident for operators based outside the EEA.



Passenger Europe



Cargo Europe



**ANNEX B: FULLY FLEXIBLE (BUSINESS) FARES: PERCENTAGE DIFFERENCE BETWEEN CARRIER AND IATA FARES**

		2001	2004
<b>To Brussels from:</b>	Amsterdam	-18.0%	-14.2%
	Copenhagen	-13.7%	-31.9%
	Lisbon	-15.5%	-20.3%
	London	-27.5%	-15.3%
	Milan	-20.5%	-23.9%
	Oslo	-20.6%	-30.4%
	Stockholm	-28.0%	-47.3%
	Vienna	-20.6%	-48.3%
	<b>To Paris from:</b>	Amsterdam	-26.3%
Helsinki		-31.0%	-29.0%
Lisbon		-16.4%	-20.5%
London		-14.7%	-20.9%
Madrid		-22.5%	-35.4%
Milan		-13.5%	-1.4%
Oslo		-17.4%	-22.3%
Stockholm		-16.4%	-20.1%
Vienna		-17.3%	-15.1%
<b>To Madrid from:</b>	Amsterdam	-21.2%	-26.9%
	Copenhagen	-17.2%	-42.4%
	Lisbon	-13.3%	-10.2%
	London	-3.0%	-6.0%
	Milan	-3.0%	-12.2%
	Oslo	-27.7%	-25.7%
	Paris	-2.0%	0.0%
	Stockholm	-22.4%	-38.3%
	Vienna	-39.1%	-48.6%
<b>To Copenhagen from</b>	Amsterdam	-29.0%	-44.3%
	Helsinki	-16.2%	-34.1%
	Lisbon	-33.7%	-48.3%
	London	-12.7%	-14.8%
	Madrid	-18.5%	-16.9%
	Milan	-21.0%	-24.4%
	Oslo	-10.9%	-53.3%
	Paris	-14.9%	-10.9%
	Vienna	-26.9%	-26.3%

Cont'd ...

		2001	2004
<b>To London from:</b>	Amsterdam	-27.6%	-30.5%
	Copenhagen	-19.7%	-41.4%
	Lisbon	-17.3%	-16.4%
	Milan	-12.6%	-23.8%
	Oslo	-23.1%	-28.9%
	Paris	-10.4%	-18.6%
	Stockholm	-17.3%	-26.3%
	Vienna	-37.0%	-43.6%
<b>Summary statistics:</b>	<b>Mean</b>	-19.5%	-26.5%
	<b>Std Dev</b>	8.2%	13.4%
	<b>Range</b>	37.1%	53.3%
	<b>Minimum</b>	-39.1%	-53.3%
	<b>Maximum</b>	-2.0%	0.0%

*Source:* IATA fares analysis. The full dataset is reproduced in the accompanying CRA paper on the claimed restrictive effects of the IATA interline system. The analysis compares business carrier fares to the IATA fare – a negative percentage differential indicates that the IATA fare exceeds the business fare.



***International Air Transport Association***

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Switzerland

**ANNEX VII**

**COMMENTS OF IATA ON**

**DG COMPETITION CONSULTATION PAPER CONCERNING  
REGULATION 1617/93**

**ADDITIONAL EXPLANATION OF THE IATA MULTILATERAL  
PASSENGER TARIFF INTERLINE SYSTEM**

## **Additional Explanation of the IATA Multilateral Passenger Tariff Interline System**

(Source: IATA's Response to the February 2001 DG Competition Consultation Paper)

Interline tickets offer a convenient, user-friendly solution to the major problem faced by the time-sensitive passenger, and those who do not live in major hubs – how to maintain maximum flexibility and thus use time efficiently in the face of the bewildering array of possible timings, routings, carriers and fare conditions that is inherent in a complex global network industry. In the event of unforeseen circumstances, a passenger's choice of a particular carrier-specific or "on-line" ticket could result in an unacceptable delay or significant extra expense for that passenger because of the ticket's limitation to a single carrier/alliance. With an interline ticket in contrast, the risk of delay is minimized and the risk of significant extra expense eliminated because the passenger has access to the maximum range of alternative carriers, routings and timings.

IATA fares represent a price-convenience trade-off: IATA fares give travellers the option of paying slightly more upfront to have the possibility of taking a more convenient combination of flights or routings and thereby save time and money in the long run. As such, the interline ticket represents an indispensable risk management tool for time-sensitive passengers worldwide. Furthermore, even after the expansion of individual airline networks and the development of airline alliances, there remain many city pairs where there is either no on-line option, or the on-line options are inadequate to meet consumer needs. In the EEA [6,467] origin-destination city pairs have IATA interlinable fares allowing travel via numerous possible routings and giving passengers the benefits of through-checking and transfer of baggage between flights, at a price lower than the sum of airline-specific fares for each sector flown.

[...]

Interlining, as facilitated by the IATA passenger tariff conferences, consists of travel or potential travel involving multiple airlines on a single ticket, bought in a single transaction, using a single currency, which offers a passenger through-checked baggage, and a high degree of flexibility as to timing, routing and carrier. Procedures established in IATA also have the aim, in the event of irregular operations, of getting the passenger to his or her destination as quickly as possible with the minimum of inconvenience using the resources of all participants. Furthermore, the IATA tariff conferences are at the core of the common standards and systems for reservations, tickets, passenger handling, baggage, and data transfer that make multilateral interlining possible and efficient. IATA interlining therefore reflects commitments made by the airlines that participate in the IATA system:

- First, where an airline issues a ticket at an IATA fare that includes a segment operated by a different carrier, the second carrier agrees to accept that booking (subject to availability) without an *ad hoc* negotiation of the relevant fare payable to the second carrier or the need to identify a carrier-specific fare sold by the second carrier that would meet the customer's travel needs. This allows creation of a booking in real time using computerized reservation systems.
- Second, where an airline issues a ticket at an IATA fare involving a connecting itinerary that includes a segment on another airline, the method for determining the amount payable to the second airline is in place, without the need for *ad hoc* negotiation. This



produces a level that is lower than the applicable point-to-point fare on the sector. Furthermore, the airlines each agree to standard protocols for processing bookings that allow through-passenger checking and transfer of baggage.

- Third, where an airline issues a ticket at an IATA fare, regardless of the carriers named on the ticket, IATA carriers (including carriers not part of the original booking) will accept that ticket for travel on the itinerary specified in the ticket or on a comparable itinerary with minimal inconvenience for the traveller in part because the fare for the desired travel on the new carrier will be a fare common to both airlines and one which, if necessary, can be used on a new itinerary (subject to certain distance limitations). Not only is the ticket itself a negotiable instrument, but the fare is, in effect, written in a common currency acceptable around the world.
- Fourth, where an airline issues a ticket at an IATA fare, the ticketing carrier collects the revenue and pays relevant travel agent commissions, credit card charges, CRS booking fees, and applicable taxes. Other carriers that actually carry a passenger (including airlines not named in the itinerary, where a passenger has exercised the right to change the booking) are then paid for their share of revenue generated by the ticket.<sup>1</sup>

Thus the IATA system relies on: (i) commitments by participating carriers to accept bookings on the basis of a sharing of revenues according to a preset formula based on an agreed total revenue; (ii) commitments by participating carriers to accept tickets held by passengers who have changed their plans on the basis of the same sharing of revenues based on an agreed total; (iii) commitments by participating carriers to facilitate these arrangements through coordination of booking information and baggage handling; and (iv) commitment by the ticketing carrier in each case to pay the costs of the booking and reimburse the airlines that actually carry the passenger, even where the ticketing carrier itself does not actually transport the passenger.

In effect, the IATA interline ticket is a product distinct from either an on-line ticket offered by an individual airline or from a ticket offering travel on two or more airlines according to a bilateral arrangement or alliance, which is only valid for transport on those airlines (or within the particular alliance). It is a product that no airline or selective grouping of airlines could fully duplicate alone.

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<sup>1</sup> It should be noted in this context that the IATA system does not prevent the ticketing carrier from selling an IATA interline ticket to a consumer at a discount from the published IATA fare. Nor does the IATA system prevent the ticketing carrier from compensating its travel agencies in the manner it considers to be appropriate. Up-front discounts would be unusual, however, since the fully flexible nature of the IATA product means that the passenger could change the booking and not use the services of the ticketing carrier at all. In these circumstances, the ticketing carrier would still be liable to reimburse the transporting carrier at the full applicable percentage of the IATA fare. Airlines participating in a booking can also themselves provide discounts in the form of rebates to passengers who actually travel on their services. Such rebates frequently constitute a feature of airline contracts with corporate customers.